APPENDIX A — PUBLISHED OPINION OF THE UNITED STATES COURT OF APPEALS FOR THE ELEVENTH CIRCUIT DATED MARCH 24, 2000

IN RE: Leroy Charles GRIFFITH,

Debtor.

Leroy Charles Griffith,

Plaintiff-Appellant,

v.

United States of America,

Defendant-Appellee.

No. 97-4845.

United States Court of Appeals,
Eleventh Circuit.

March 24, 2000.

* * *

Appeal from the United States District Court for the Southern District of Florida.

Before ANDERSON, Chief Judge, and TJOFLAT, EDMONDSON, COX, BIRCH, DUBINA, BLACK, CARNES, BARKETT, HULL, MARCUS and WILSON, Circuit Judges.

Appendix A

BIRCH, Circuit Judge:

This appeal requires us to determine the scope of nondischargeability of tax debts under 11 U.S.C. § 523(a)(1)(C). Specifically, we requested the parties in this case to address the question of whether § 523(a)(1)(C) renders a tax debt nondischargeable in bankruptcy where the debtor has willfully attempted in any manner to evade or defeat the payment of a tax but has not in any manner willfully attempted to evade or defeat the assessment of a tax. Because we find that § 523(a)(1)(C) does render nondischargeable tax debts where the debtor has willfully attempted in any manner to evade or defeat the payment of a tax and because the bankruptcy and district courts did not clearly err in finding that Debtor Leroy Charles Griffith's actions constituted a willful attempt to evade or defeat the payment of a tax, we AFFIRM the finding that Griffith's tax debts are nondischargeable.

I. Background

We adopt and reiterate the factual background as written by the panel that originally heard this case:

Plaintiff-appellant Leroy Charles Griffith ("Griffith") has long been the sole owner of several corporations primarily involved in the adult entertainment industry. These corporations included, among others, Gayety Theaters, Inc. ("Gayety"), Ell Gee, Inc., and Paris Follies, Inc. As subchapter S corporations, the income and deductions pass through to the shareholders, so Griffith's personal income tax returns reflect the performance of his corporations. An

Appendix A

IRS audit revealed that Griffith had substantially underpaid his taxes for the years 1969, 1970, 1972-1976, and 1978. Griffith petitioned the Tax Court for a reconsideration of the amount owed. In a detailed opinion issued in September of 1988, the Tax Court found that Griffith had indeed underpaid his taxes, but did not impose fraud penalties because the government's evidence with respect to fraud did not satisfy the clear and convincing burden of proof. See Griffith v. Commissioner, 56 T.C.M. (CCH) 220, 1988 WL 95665 (1988), modified, 56 T.C.M. (CCH) 1263, 1989 WL 11176 (1989). With interest, the amount of taxes owed at the time that Griffith filed for bankruptcy in this case was close to $2,000,000. See In re Griffith, 161 B.R. 727, 730 (Bankr.S.D.Fla.1993), aff'd, 210 B.R. 216 (S.D.Fla.1997), rev'd, 174 F.3d 1222 (11th Cir.), vacated and reh'g en banc granted, 182 F.3d 1297 (11th Cir.1999).

Less than a month after the Tax Court issued its decision, on October 10, 1988, NuWave, Inc., was incorporated, with Griffith's long-time live-in girlfriend, Linda, as sole shareholder. On June 8, 1989, Linda and Griffith married, and Griffith signed an antenuptial agreement in which he transferred all of his stock in Gayety, Ell Gee, and Paris Follies to Linda and himself as tenants in the entirety, along with $390,000 in promissory notes. Assets from another corporation that he owned were transferred to NuWave, Inc. The IRS made an assessment against Griffith on September 28, 1989. However, the assets transferred pursuant to the antenuptial agreement were insulated from being levied upon because assets held by tenants in the entirety cannot be levied upon without a judgment against both owners. Additionally, Griffith no longer had any ownership interest in those assets transferred to NuWave, Inc.

Appendix A

On January 15, 1993, Griffith filed a Chapter 7 bankruptcy petition, as well as a complaint to determine the dischargeability of his tax debts. The government argued that the tax debts were nondischargeable under 11 U.S.C. § 523(a)(1)(C), which prohibits discharge of taxes "with respect to which the debtor made a fraudulent return or willfully attempted in any manner to evade or defeat such tax." The bankruptcy court agreed. Although there was no evasion with respect to the assessment of the tax, the bankruptcy court, looking to the "badges of fraud," found that Griffith's conduct occurring after the Tax Court issued its decision amounted to a willful attempt to evade or defeat the payment of the tax debt. See In re Griffith, 161 B.R. at 733-34. The court specifically rejected Griffith's argument that §§ 523(a)(1)(C) applies only to conduct constituting evasion of the assessment of a tax; the court held that the phrase "in any manner" was sufficiently broad to include conduct constituting evasion of the payment of a tax. See id. at 732-33.

Subsequent to the bankruptcy court's decision, we decided In re Haas, 48 F.3d 1153 (11th Cir.1995). Haas had filed accurate tax returns, but had not paid the taxes due; instead, he used his income to pay business and personal debts. Upon filing for bankruptcy, he sought discharge of the tax debts, which the government opposed on the basis of § 523(a)(1)(C). Noting the "fresh start" policy underlying the bankruptcy laws, the Haas panel found that a literal reading of the statute, including the broad phrase "in any manner," would conflict with the goals of bankruptcy. See id. at 1156. Thus, the panel looked to provisions of the Internal Revenue Code ("I.R.C.") and found that they referred

to "willfully attempting in any manner to evade or defeat any tax or the payment thereof." See id. (quoting 26 U.S.C. § 6531(2)) (emphasis added); see also id. (quoting 26 U.S.C. §§ 6653, 6672, & 7201, which contain the identical language as that emphasized in the above quote). The panel relied on the absence of the phrase "or the payment thereof" from § 523(a)(1)(C) to conclude that the provision precludes discharge when the debtor "willfully attempted . . . to evade or defeat" the tax at the assessment stage, but does not preclude discharge when there has been such evasion at the payment stage. See id. at 1159. Thus, Haas' debt was dischargeable.

Griffith appealed the bankruptcy court's decision in the instant case to the district court, relying heavily on the intervening decision in Haas. The district court affirmed the bankruptcy court's decision. See In re Griffith, 210 B.R. 216, 220 (S.D.Fla.1997), rev'd, 174 F.3d 1222 (11th Cir.), vacated and reh'g en banc granted, 182 F.3d 1297 (11th Cir.1999). In so doing, it distinguished Haas. The district court found that, unlike Haas, Griffith had done more than simply pay other debts before paying his back taxes; Griffith had engaged in a fraudulent transfer of assets in order to prevent collection of his tax debt. See id. at 219. Griffith appealed to this court.[1]

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1. The panel rejected Griffith's contention that the bankruptcy court abused its discretion in allowing the government to amend to assert specifically its § 523(a)(1)(C) counterclaim. We reaffirm that holding.

Appendix A

II. Discussion

This case requires us to interpret § 523(a)(1)(C), which states that:

> (a) A discharge under section 727, 1141, 1228(a), 1228(b), or 1328(b) of this title does not discharge an individual debtor from any debt —
>
> (1) for a tax or customs duty —
>
> . . .
>
> (C) with respect to which the debtor made a fraudulent return or willfully attempted in any manner to evade or defeat such tax. . . .

We do not conduct this enterprise against an empty slate. Several courts, including this court in Haas, have addressed the application of § 523(a)(1)(C) to persons who failed to pay their tax debts before entering bankruptcy. While most of the courts that have addressed this issue agree with our primary holding in Haas "that a debtor's failure to pay his taxes, alone, does not fall within the scope of section 523(a)(1)(C)'s exception to discharge in bankruptcy," 48 F.3d at 1158, our second holding, that "the phrase 'attempt[s] in any manner to evade or defeat such tax' does not imply attempts to evade or defeat payment thereof," id. at 1159 (alteration in original), has been more controversial. See, e.g., In re Fegeley, 118 F.3d 979, 983 (3d Cir.1997) (accepting first holding from Haas but finding that nonpayment of taxes is relevant to the question of whether

tax debts are nondischargeable under § 523(a)(1)(C)); In re Birkenstock, 87 F.3d 947, 951-52 (7th Cir.1996) (accepting first holding from Haas but holding that "where nonpayment is coupled with a pattern of failing to file tax returns or where a defendant takes other measures to conceal assets or income from the IRS, a court may reasonably find that the debtor sought to 'evade or defeat' his tax liabilities") (citations omitted); Dalton v. IRS, 77 F.3d 1297, 1301 (10th Cir.1996) (accepting first holding from Haas but finding that "any statutory interpretation of 'evade and defeat' which relieves the dishonest debtor who conceals assets to avoid the payment or collection of taxes, but which penalizes the same dishonesty to avoid assessment, would be an absurd result"); see also In re Tudisco, 183 F.3d 133, 137 (2d Cir.1999) (refusing to pass on question of whether mere nonpayment is sufficient to render tax debts nondischargeable under § 523(a)(1)(C) but, instead, finding that the fact that the debtor had "engaged in more than 'mere nonpayment' " meant that he had attempted to evade or defeat his taxes). But see In re Bruner, 55 F.3d 195, 200 (5th Cir.1995) (rejecting both holdings of Haas). Because we find that § 523(a)(1)(C) renders nondischargeable tax debts where the debtor willfully attempted to evade or defeat payment of taxes and because we find that the bankruptcy court did not err in finding that Griffith had willfully attempted to evade payment of his taxes, we affirm the district court's affirmance of the bankruptcy court's finding of nondischargeability.

A. Statutory Interpretation

Interpretation of a statute begins "with the language of the statute itself." United States v. Ron Pair Enters., 489

U.S. 235, 241, 109 S.Ct. 1026, 1030, 103 L.Ed.2d 290 (1989). As a general rule, if the language of the statute is plain, then our interpretative function ceases and we should " 'enforce [the statute] according to its terms.' " Id. (quoting Caminetti v. United States, 242 U.S. 470, 485, 37 S.Ct. 192, 194, 61 L.Ed. 442 (1917)).

In interpreting the language of a statute, we generally give "the 'words used' their 'ordinary meaning.' " Moskal v. United States, 498 U.S. 103, 108, 111 S.Ct. 461, 465, 112 L.Ed.2d 449 (1990) (quoting Richards v. United States, 369 U.S. 1, 9, 82 S.Ct. 585, 591, 7 L.Ed.2d 492 (1962)). We also use interpretative tools, the "canons of construction," which "are no more than rules of thumb that help courts determine the meaning of legislation." Connecticut Nat'l Bank v. Germain, 503 U.S. 249, 253, 112 S.Ct. 1146, 1149, 117 L.Ed.2d 391 (1992). Among these canons of construction are the principles "that Congress is presumed to be aware of judicial interpretations of a statute," NLRB v. Bildisco & Bildisco, 465 U.S. 513, 524, 104 S.Ct. 1188, 1195, 79 L.Ed.2d 482 (1984), superseded by statute on other grounds, 11 U.S.C. § 1113 (1984), that "courts should disfavor interpretations of statutes that render language superfluous," Connecticut Nat'l Bank, 503 U.S. at 253, 112 S.Ct. at 1149, and that "[w]e assume that Congress is aware of existing law when it passes legislation," Miles v. Apex Marine Corp., 498 U.S. 19, 32, 111 S.Ct. 317, 325, 112 L.Ed.2d 275 (1990). "Legislative history can be a legitimate guide to a statutory purpose obscured by ambiguity." Burlington N. R.R. Co. v. Oklahoma Tax Comm., 481 U.S. 454, 461, 107 S.Ct. 1855, 1860, 95 L.Ed.2d 404 (1987).

Appendix A

The Government, focusing on the clause "in any manner," argues that the plain language of § 523(a)(1)(C) renders nondischargeable tax debts where the debtor willfully attempts to avoid either assessment or collection of a tax. We "generally construe the statutory exceptions to discharge in bankruptcy 'liberally in favor of the debtor' " in order to "ensure[ ] that the 'honest but unfortunate debtor' is afforded a fresh start." In re Miller, 39 F.3d 301, 304 (11th Cir.1994) (quoting, respectively, In re Tully, 818 F.2d 106, 110 (1st Cir.1987) and Birmingham Trust Nat'l Bank v. Case, 755 F.2d 1474, 1477 (11th Cir.1985), superseded on other grounds by Pub L. No. 98-353, 98 Stat. 333 (1984)). As we discussed in Haas, however, the broadest possible reading of § 523(a)(1)(C), i.e., that a tax debt is nondischargeable whenever "a debtor had both an awareness of his duty to pay his taxes and the present ability to pay them but nonetheless failed to satisfy that duty," would render virtually all tax debts nondischargeable. 48 F.3d at 1155. To read § 523(a)(1)(C) to render tax debts nondischargeable in cases, like Haas, where the debtor merely failed to pay his taxes, would extinguish the general rule in favor of dischargeability of tax debts. Thus, we reaffirm our first holding from Haas that mere nonpayment of taxes is insufficient to establish the exception found in § 523(a)(1)(C). See id. at 1158.

We turn to the question of whether § 523(a)(1)(C) applies to a willful attempt to evade or defeat collection of taxes where the debtor engaged in affirmative acts other than mere nonpayment of the taxes. Our conclusion in Haas that § 523(a)(1)(C) does not apply to attempts to evade or defeat collection of taxes was premised, in part, on the phrasing of § 523(a)(1)(C) as compared with four provisions of the

Internal Revenue Code. Unlike § 523(a)(1)(C), which never mentions either "collection" or "payment," these four provisions each address willful attempts "in any manner to evade or defeat any tax or the payment thereof." I.R.C. § 6531(2) (emphasis added); see also I.R.C. §§ 6653(2), 6672(a), 7201. Applying the canons of interpretation that Congress is presumed to know the content of existing, relevant law, Haas, 48 F.3d at 1157, and that, "[w]here Congress knows how to say something but chooses not to, its silence is controlling," id. at 1156, we held that Congress must have consciously chosen not to include the language "or the payment thereof" in § 523(a)(1)(C), id. at 1157. In reaching this conclusion, we acknowledged that, because § 523(a)(1)(C) is part of a separate statute and title than the I.R.C., where these other provisions are found, these canons of construction are somewhat weaker, but we found that, in light of the prominence of I.R.C. § 7201, we could presume that Congress was aware of the language in § 7201 but consciously chose not to mirror it. Id. at 1157.[2]

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2. One possibility not addressed by either party is that the language in I.R.C. § 7201 reflects the relationship between I.R.C. § 7201, which makes it a felony for "[a]ny person [to] willfully attempt[ ] in any manner to evade or defeat any tax imposed by this title or the payment thereof," and I.R.C. § 7203, which makes it a misdemeanor for "[a]ny person required under this title to pay any estimated tax or tax . . . [to] willfully fail[ ] to pay such estimated tax or tax. . . ." The Supreme Court, addressing the predecessor statutes to §§ 7201 and 7203, noted that there was not a bright line between the conduct covered by the two statutory provisions. See Spies v. United States, 317 U.S. 492, 497, 63 S.Ct. 364, 367, 87 L.Ed. 418 (1943) ("The difference between willful failure to pay a tax when due, which is made a misdemeanor, and willful attempt to

(Cont'd)

Appendix A

While we believe that the application of the canons of construction produced a plausible interpretation of § 523(a)(1)(C) in Haas, we now conclude that the more reasonable interpretation of § 523(a)(1)(C) is that it renders nondischargeable tax debts where the debtor engaged in affirmative acts seeking to evade or defeat collection of taxes. This interpretation accords well with the interests that Congress was attempting to balance in enacting the predecessor statute to § 523(a)(1)(C): to permit "an honest but financially unfortunate debtor [to make] a fresh start unburdened by what may be an overwhelming liability for

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defeat and evade one, which is made a felony, is not easy to detect or define."). By including the language "or the payment thereof" in § 7201, Congress ensured that courts would not incorrectly create a sharp demarcation between the conduct covered by § 7201 (i.e., failure to pay a tax) and the conduct covered by § 7203 (i.e., evasion of a tax, whether by evasion of assessment or collection), but, instead, would use a more subtle distinction to determine whether failure to pay constituted a misdemeanor, a felony, or neither. See id. at 499, 63 S.Ct. 364 ("Willful but passive neglect of the statutory duty may constitute the lesser offense, but to combine with it a willful and positive attempt to evade tax in any manner or to defeat it by any means lifts the offense to the degree of felony."); see also Sansone v. United States, 380 U.S. 343, 351, 85 S.Ct. 1004, 1010, 13 L.Ed.2d 882 (1965) (applying Spies to §§ 7201 and 7203). In contrast to the I.R.C., there is no provision like § 7203 in the bankruptcy code and, thus, Congress may have deemed it less necessary to include the language "or the payment thereof" in § 523(a)(1)(C). See also In re Toti, 24 F.3d 806, 808-09 (6th Cir.1994) (rejecting claim that § 523(a)(1)(C) only applies to behavior covered by § 7201 and finding that § 523(a)(1)(C) renders nondischargeable tax debts where debtor was convicted under § 7203).

accumulated taxes," while avoiding the creation of "a tax evasion device." S.Rep. No. 89-1158 (1966), reprinted at 1966 U.S.C.C.A.N. 2468. As the Tenth Circuit recognized, an interpretation of § 523(a)(1)(C) that permits a debtor to engage in affirmative behavior in order to evade collection of taxes serves neither of those purposes, but, instead, advantages dishonest debtors. See Dalton, 77 F.3d at 1301.

Principles of statutory interpretation also support our conclusion that § 523(a)(1)(C) renders nondischargeable tax debts where the debtor engaged in affirmative acts seeking to evade payment of taxes. As other courts have noted, interpreting § 523(a)(1)(C) so that it does not apply to attempts to evade payment of taxes would mean that the phrase "willfully attempted in any manner to evade or defeat taxes" would only apply to persons who filed a fraudulent return. See id. at 1301 & n. 4; In re Jones, 116 B.R. 810, 815 & n. 1 (Bankr.D.Kan.1990) (noting that, because nondischargeability of tax debts due to failure to file a tax return is covered by § 523(a)(1)(B)(i), "this court is hard-pressed to conceive how a debtor might willfully attempt to evade or defeat a tax without also filing a fraudulent return"). Such an interpretation, however, would render the phrase "willfully attempted in any manner to evade or defeat taxes" superfluous because § 523(a)(1)(C) expressly renders nondischargeable tax debts where the debtor filed a fraudulent tax return. See Dalton, 77 F.3d at 1301; Jones, 116 B.R. at 815. Thus, concluding that § 523(a)(1)(C) renders nondischargeable willful attempts to evade or defeat payment of taxes conforms with the principle that we "disfavor interpretations of statutes that render language superfluous," Connecticut Nat'l Bank, 503 U.S. at 253, 112 S.Ct. at 1149;

see also In re Gilder, 122 B.R. 593, 595 (Bankr.M.D.Fla. 1990) (noting that prongs of § 523(a)(1)(C) should be "read in the disjunctive"). Finally, we note that courts have traditionally been reluctant to limit the means by which a taxpayer may "willfully attempt in any manner to evade or defeat" taxes. See Spies, 317 U.S. at 499, 63 S.Ct. at 368 ("Congress did not define or limit the methods by which a willful attempt to defeat and evade might be accomplished and perhaps did not define lest its effort to do so result in some unexplained limitation. Nor would we by definition constrict the scope of the Congressional provision that it may be accomplished 'in any manner'."); see also Dalton, 77 F.3d at 1301 (applying Spies to interpretation of § 523(a)(1)(C)); Toti, 24 F.3d at 809 (finding that "willfully attempted to evade" taxes includes "voluntary, conscious, and intentional evasions of tax liabilities," including conscious failure to file a return and to pay taxes).

Accordingly, while we reaffirm the primary holding of Haas that mere nonpayment of taxes, without more, does not constitute a willful attempt to evade or defeat taxes under § 523(a)(1)(C), we hold that § 523(a)(1)(C) does render nondischargeable tax debts where the debtor engaged in affirmative acts constituting a willful attempt to evade or defeat payment of taxes.

B. Application

In light of our conclusion that § 523(a)(1)(C) does apply to debtors who willfully attempt to evade or defeat payment of taxes, we must address the question of whether Griffith's actions constitute a willful attempt to evade or defeat his

taxes. The Government bears the burden to prove, by a preponderance of the evidence, that a particular claim is nondischargeable under § 523(a). See Grogan v. Garner, 498 U.S. 279, 287-88, 111 S.Ct. 654, 659-60, 112 L.Ed.2d 755 (1991). The willful attempt to evade prong of 523(a)(1)(C) includes "both a conduct requirement (that the debtor sought 'in any manner to evade or defeat' his tax liability) and a mental state requirement (that the debtor did so 'willfully')." Birkenstock, 87 F.3d at 951 (quoting § 523(a)(1)(C)). It is undisputed that Griffith engaged in intra-family transfers of property for little to no consideration.[3] In light of our holding in this case, we find that the district court did not err in affirming the bankruptcy court's finding that Griffith had engaged in conduct covered by § 523(a)(1)(C). See id. at 952 (affirming bankruptcy court's finding of an attempt to evade taxes where debtors transferred property into trust for no consideration while still maintaining control over the property); Dalton, 77 F.3d at 1303 (holding that transfer of property to betrothed for insufficient consideration with knowledge of tax investigation supported finding of willful attempt to evade or defeat taxes); In re Sternberg, 229 B.R. 238, 248 (S.D.Fla.1998) (finding that transfer of property to wife for little consideration while maintaining control over the property constituted a willful attempt to evade or defeat taxes); Jones, 116 B.R. at 815 (finding that transfer of property to others constituted an attempt to evade or defeat taxes).

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3. The bankruptcy court also noted that Griffith engaged in "personal-corporate commingling of funds" but considered that only as evidence of Griffith's intent to evade his tax liability. Griffith, 161 B.R. at 733.

Several other courts use a three-prong test to determine whether a debtor's failure to pay his tax liability was willful under § 523(a)(1)(C): whether "(1) the debtor had a duty under the law, (2) the debtor knew he had that duty, and (3) the debtor voluntarily and intentionally violated that duty." Bruner, 55 F.3d at 197; see also Birkenstock, 87 F.3d at 952 (stating same test as two prongs).[4] Applying this test, we find that the district court did not err in affirming the bankruptcy court's finding of willfulness. It is undisputed that Griffith had a duty under the law to pay taxes and that Griffith knew that he had that duty. On the issue of whether Griffith voluntarily and intentionally violated that duty, the bankruptcy court, in addition to noting that both Griffith and his wife Linda were "evasive and lacked that ring of forthrightness reflective of an open and credible witness," Griffith, 161 B.R. at 734, looked to the traditional "badges of fraud" to determine that Griffith's conduct constituted a willful attempt to evade his tax obligations, id. at 733. The bankruptcy court's finding that Griffith's transfer of property to Linda implicated several badges of fraud, including being "an exchange to a family member, during a period of serious

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4. We note that the fact that Tax Court found that the Government had not proved that Griffith had engaged in fraud, see Griffith v. Commissioner of Internal Revenue, 56 T.C.M. (CCH) 220, 1988 WL 95665, modified, 56 T.C.M. (CCH) 1263, 1989 WL 11176 (1989), does not bar the bankruptcy court's finding of willfulness in this case. Unlike in the bankruptcy case, where the Government's burden of proof is preponderance of the evidence, the Government's burden of proof as to the fraud claims in the Tax Court was the clear and convincing evidence standard. See id. Additionally, the Tax Court's analysis does not address Griffith's transfers of property to Linda or other actions taken by Griffith post-assessment of the taxes at issue in this case. See id.

financial difficulty, for inadequate consideration," id. at 734, is not clearly erroneous. These findings are sufficient to justify a finding of fraud and, thus, to support the finding that Griffith's conduct was willful. See Sternberg, 229 B.R. at 246 ("While a single badge of fraud may amount to only a suspicious circumstance, a combination of them will justify a finding of fraud.").

III. Conclusion

We AFFIRM the district court's order affirming the bankruptcy court's determination that Griffith's tax debts are nondischargeable under § 523(a)(1)(C).

APPENDIX B — PUBLISHED OPINION OF THE UNITED STATES COURT OF APPEALS FOR THE ELEVENTH CIRCUIT DATED MAY 11, 1999

In re: Leroy Charles GRIFFITH,

Debtor.

Leroy Charles Griffith,

Plaintiff-Appellant,

v.

United States of America,

Defendant-Appellee.

No. 97-4845.

United States Court of Appeals,
Eleventh Circuit.

May 11, 1999.

* * *

Appeal from the United States District Court for the Southern District of Florida.

Before ANDERSON, DUBINA and BLACK, Circuit Judges.

Appendix B

ANDERSON, Circuit Judge:

This case raises the issue of whether certain tax debts are dischargeable in bankruptcy despite the debtor's efforts to evade payment of the taxes by transferring assets to his wife. The district court found that such tax debts are not dischargeable. Binding circuit precedent requires us to reverse.

I. FACTS

Plaintiff-appellant Leroy Charles Griffith ("Griffith") has long been the sole owner of several corporations primarily involved in the adult entertainment industry. These corporations included, among others, Gayety Theaters, Inc. ("Gayety"), Ell Gee, Inc., and Paris Follies, Inc. As subchapter S corporations, the income and deductions pass through to the shareholders, so Griffith's personal income tax returns reflect the performance of his corporations. An IRS audit revealed that Griffith had substantially underpaid his taxes for the years 1969, 1970, 1972-1976, and 1978. Griffith petitioned the Tax Court for a reconsideration of the amount owed. In a detailed opinion issued in September of 1988, the Tax Court found that Griffith had indeed underpaid his taxes, but did not impose fraud penalties because the government's evidence with respect to fraud did not satisfy the clear and convincing burden of proof. See Griffith v. Commissioner, 56 T.C.M. (CCH) 220, 1988 WL 95665 (1988), modified, 56 T.C.M. (CCH) 1263, 1989 WL 11176 (1989). With interest, the amount of taxes owed at the time that Griffith filed for bankruptcy in this case was close to $2,000,000. See In re Griffith, 161 B.R. 727, 730 (Bankr.S.D.Fla.1993).

Appendix B

Less than a month after the Tax Court issued its decision, on October 10, 1988, NuWave, Inc. was incorporated, with Griffith's long-time live-in girlfriend, Linda, as sole shareholder. On June 8, 1989, Linda and Griffith married, and Griffith signed an antenuptial agreement in which he transferred all of his stock in Gayety, Ell Gee, and Paris Follies to Linda and himself as tenants in the entirety, along with $390,000 in promissory notes. Assets from another corporation that he owned were transferred to NuWave, Inc. The IRS made an assessment against Griffith on September 28, 1989. However, the assets transferred pursuant to the antenuptial agreement were insulated from being levied upon because assets held by tenants in the entirety cannot be levied upon without a judgment against both owners. Additionally, Griffith no longer had any ownership interest in those assets transferred to NuWave, Inc.

On January 15, 1993, Griffith filed a Chapter 7 bankruptcy petition, as well as a complaint to determine the dischargeability of his tax debts. The government argued that the tax debts were nondischargeable under 11 U.S.C. § 523(a)(1)(C), which prohibits discharge of taxes "with respect to which the debtor made a fraudulent return or willfully attempted in any manner to evade or defeat such tax." The bankruptcy court agreed. Although there was no evasion with respect to the assessment of the tax, the bankruptcy court, looking to the "badges of fraud," found that Griffith's conduct occurring after the Tax Court issued its decision amounted to a willful attempt to evade or defeat the payment of the tax debt. See id. at 733-34. The court specifically rejected Griffith's argument that § 523(a)(1)(C) applies only to conduct constituting evasion of the

assessment of a tax; the court held that the phrase "in any manner" was sufficiently broad to include conduct constituting evasion of the payment of a tax. See id. at 732-33.

Subsequent to the bankruptcy court's decision, the Eleventh Circuit decided In re Haas, 48 F.3d 1153 (11th Cir.1994). Haas had filed accurate tax returns, but had not paid the taxes due; instead, he used his income to pay business and personal debts. Upon filing for bankruptcy, he sought discharge of the tax debts, which the government opposed on the basis of § 523(a)(1)(C). Noting the "fresh start" policy underlying the bankruptcy laws, the Haas panel found that a literal reading of the statute, including the broad phrase "in any manner," would conflict with the goals of bankruptcy. See id. at 1156. Thus, the panel looked to provisions of the Internal Revenue Code ("I.R.C.") and found that they referred to "willfully attempting in any manner to evade or defeat any tax or the payment thereof." See id. (quoting 26 U.S.C. § 6531(2)) (emphasis added); see also id. (quoting §§ 6653, 6672, & 7201, which contain the identical language as that emphasized in the above quote). The panel relied on the absence of the phrase "or the payment thereof" from § 523(a)(1)(C) to conclude that the provision precludes discharge when the debtor "willfully attempt[ed] . . . to evade or defeat" the tax at the assessment stage, but does not preclude discharge when there has been such evasion at the payment stage. See id. at 1159. Thus, Haas' debt was dischargeable.

Griffith appealed the bankruptcy court's decision in the instant case to the district court, relying heavily on the

intervening decision in Haas. The district court affirmed the bankruptcy court's decision. See In re Griffith, 210 B.R. 216, 220 (S.D.Fla.1997). In so doing, it distinguished Haas. The district court found that, unlike Haas, Griffith had done more than simply pay other debts before paying his back taxes; Griffith had engaged in a fraudulent transfer of assets in order to prevent collection of his tax debt. See id. at 219. Griffith appealed to this court.[1]

II. DISCUSSION

A. The Scope of Haas and its Application to this Case

Our resolution of this case depends on an interpretation of the scope of § 523(a)(1)(C). As several other appellate courts have noted, § 523(a)(1)(C) contains both a mens rea requirement ("willfulness") and a conduct requirement ("attempting to evade or defeat such tax"). See, e.g., In re Birkenstock, 87 F.3d 947, 951 (7th Cir.1996).[2] In Haas, the panel focused on the conduct requirement and determined that Haas's conduct did not amount to an attempt to evade or defeat his tax liability. The conduct at issue in Haas was as follows: Haas had not concealed assets or otherwise evinced a motive to evade taxes; because of financial

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1. We reject Griffith's contention that the bankruptcy court abused its discretion in allowing the government to amend to assert specifically its § 523(a)(1)(C) counterclaim.

2. In light of our holding, infra, that the rationale of Haas compels the conclusion that Griffith's activities to avoid payment do not come within the conduct requirement, we decline to address further the mens rea requirement in this opinion.

pressures, he had merely paid other debts, leaving the tax debt unpaid notwithstanding his knowledge thereof and ability to pay. In this case, the government argues that "[t]he facts presented in Haas are readily distinguishable from the facts presented here." Brief for the Appellee at 34. Like the district court, the government notes that Haas simply failed to pay his taxes, choosing to pay other debts first, whereas Griffith took numerous actions "pursuant to a plan to defraud the IRS." Id. at 35. The government extracts from the panel's opinion in Haas the statement that "Congress did not intend that a failure to pay taxes, without more, should result in the nondischargeability of a debtor's tax liabilities in bankruptcy." Id. at 36 (quoting Haas, 48 F.3d at 1157). Emphasizing the "without more" qualification, the government contends that "more" was found in this case, so that the conduct requirement is satisfied and nondischargeability of Griffith's tax debt should be upheld.

The distinction suggested by the government and the district court between mere nonpayment and fraudulent acts of concealment to avoid payment is an attractive reading of § 523(a)(1)(C), and one on which the Haas panel could have based its holding. See infra. However, this is not the interpretation of § 523(a)(1)(C) that the Haas panel adopted. The above quote notwithstanding, the Haas panel made clear that, in its view, § 523(a)(1)(C) prohibited discharge only when the actions taken by the debtor affected the assessment of the tax. In support of this reading, the Haas panel relied on the omission of the phrase "or the payment thereof" from § 523(a)(1)(C), in contrast to the following four sections of the I.R.C.: § 6531(2), establishing the statute of limitations period for, inter alia, the crime of "willfully attempting in

any manner to evade or defeat any tax or the payment thereof;" § 6653(2), addressing stamp taxes and sanctioning anyone who "willfully attempts in any manner to evade or defeat any such tax or the payment thereof;" § 6672(a), creating civil penalties for those who "willfully attempt[ ] in any manner to evade or defeat any such tax or the payment thereof;" and § 7201, imposing felony penalties on "[a]ny person who willfully attempts in any manner to evade or defeat any tax imposed by this title or the payment thereof."[3] The Haas panel found that the striking similarities between § 523(a)(1)(C) and each of these provisions was persuasive evidence that Congress deliberately omitted the language "or the payment thereof" from § 523(a)(1)(C). The panel continued:

> We conclude that Congress has shown itself capable of distinguishing between the evasion of a tax and the evasion of payment thereof; its decision to omit the words "or payment thereof" in section 523(a)(1)(C), despite the inclusion of these words in four previously enacted and nearly identical provisions of the I.R.C., must be given effect.

Id. at 1161. Significantly, the Haas court cited the decision of the bankruptcy court in this very case as an example of an erroneous reading of § 523(a)(1)(C). See id. at 1158.

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3. The panel noted that § 523(a)(1)(C) was part of the Bankruptcy Code, not the I.R.C., but still found the I.R.C. instructive "because Congress is presumed to be aware of pertinent, existing law when it passes legislation." Haas, 48 F.3d at 1157.

We conclude that this case is squarely governed by Haas. Pursuant to Haas, § 523(a)(1)(C) applies only to conduct constituting evasion of the assessment of a tax; it does not apply to conduct that involves evasion of the payment of a tax debt. Therefore, pursuant to the prior panel rule, we are compelled to reverse the decision of the district court and remand. See United States v. Woodard, 938 F.2d 1255, 1258 (11th Cir.1991) ("The law in this circuit is emphatic that 'only a decision by this court sitting en banc or the United States Supreme Court can overrule a prior panel decision.' " (quoting United States v. Machado, 804 F.2d 1537, 1543 (11th Cir.1986))).

B. A Narrower Approach

Although we are bound by the decision in Haas, we are troubled by its application in this case. As noted above, the underlying facts in Haas involved mere nonpayment of the tax, without more. By contrast, in the instant case, Griffith fraudulently transferred assets to his wife to evade the payment of his tax debts. We have significant doubt about whether the Haas panel would have adopted its interpretation of § 523(a)(1)(C), had it foreseen the application of that interpretation in a case like this one.

In Dalton v. IRS, 77 F.3d 1297 (10th Cir.1996), the Tenth Circuit addressed a case identical to the instant case in all relevant respects. In dicta, the Tenth Circuit indicated its agreement with the result reached in Haas — i.e., that the mere failure to pay a tax, without more, would not rise to the level of tax evasion as required by § 523(a)(1)(C). Thus, the result in Haas, could have been reached upon grounds

much narrower than the ground actually adopted by the Haas panel.[4]

While acknowledging that the result in Haas was correct, the Tenth Circuit in Dalton expressly rejected the proposition (adopted in Haas) that § 523(a)(1)(C) applies only to conduct constituting evasion of the assessment of a tax and does not apply to conduct constituting evasion of the payment or collection thereof. Like the instant case, Dalton involved only conduct evidencing attempts to evade the payment or collection of taxes. Relying upon the broad language of § 523(a)(1)(C) — "willfully attempted in any manner to evade or defeat such tax" — and in particular upon the broad phrase "in any manner," the Dalton court held that § 523(a)(1)(C) makes a tax nondischargeable when the debtor

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4. Such narrower rationale could have been as follows. If the mere nonpayment of a tax, without more, rendered a tax debt nondischargeable, that would effectively make all tax debts nondischargeable. This would be inconsistent with the Bankruptcy Code's purpose of allowing a fresh start for honest, but unfortunate, debtors, and would also be inconsistent with §§ 523(a)(1)(A) and 507(a)(8)(A)(i), which together make tax debts nondischargeable only if they become due and owing within three years of bankruptcy. Underlying this narrower rationale is the notion that evasion requires some measure of fraud or something more than merely intentional nonpayment. See Blohm v. Commissioner, 994 F.2d 1542, 1554 (11th Cir.1993) (referring to liability under § 7201 for attempts to evade or defeat tax as "a criminal tax fraud conviction" and noting that "the elements of criminal tax evasion and of civil tax fraud are identical" (quoting Gray v. Commissioner, 708 F.2d 243, 246 (6th Cir.1983)) (emphases added)). See generally Harry Graham Balter, Tax Fraud and Evasion ¶ 2.01[1] (1983) (noting that "courts do not hesitate to use the terms fraud and evasion interchangeably and cumulatively").

attempted to evade a payment or collection of the tax, even though there was no evasion with respect to the assessment thereof. Dalton, 77 F.3d at 1301. The Tenth Circuit also relied upon the purpose of Congress to relieve only "honest" debtors from their tax debts. Id. Finally, although noting the contrary ruling in Haas and in a single bankruptcy court decision, the Dalton court noted that most courts had applied § 523(a)(1)(C) to conduct constituting evasion of the payment of taxes, as well as conduct constituting evasion with respect to the assessment thereof. Id. at 1300-01.

C. Further Thoughts on the Haas Holding.

Because we are troubled by the application of the Haas holding to the facts of the instant case, because we doubt that this consequence was argued to the Haas panel, and because of the conflict in the circuits arising from the inconsistency between Haas and Dalton (and the decisions cited therein), we think that the instant case is a candidate for en banc reconsideration. For this reason, we add the further thought that the Haas panel may have overemphasized the importance of the omission of the words "or the payment thereof" from § 523(a)(1)(C). The Haas panel assumed that the language of 11 U.S.C. § 523(a)(1)(C) of the Bankruptcy Code was borrowed from identical — except for the omitted phrase — language in 26 U.S.C. § 7201 and like sections of the Internal Revenue Code. However, our research has uncovered numerous provisions of the I.R.C. that use variations of the same language.[5] If the Haas logic applied

5. See I.R.C. § 552(b)(2) (excluding from definition of "foreign personal holding company" certain corporations that the Secretary

(Cont'd)

to these provisions, they would have no application where there was only a purpose to evade the payment of the tax. Yet there is no indication in the case law or the regulations that the applicability of these other provisions is limited to the assessment of a tax, to the exclusion of the payment thereof. Congress could have borrowed from any of these

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(Cont'd)

is satisfied are "not formed or availed of for the purpose of evading or avoiding United States income taxes which would otherwise be imposed upon its shareholders"); § 5671 (establishing penalties for "whoever evades or attempts to evade any [beer] tax"); § 6111(d)(1)(A) (defining certain tax shelters in terms that include "a significant purpose . . . of which is the avoidance or evasion of Federal income tax . . . ."); § 6501(c)(2) ("In case of a willful attempt in any manner to defeat or evade tax imposed by this title . . . , the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time."); § 6662(d)(2)(C)(iii) (defining a tax shelter as, inter alia, an organization "a significant purpose of [which] is the avoidance or evasion of Federal income tax"); § 7270 (providing for enhanced fines when any person "fails to comply" with the tax requirements of insurance policies issued by foreign insurers "with intent to evade the tax"); § 7341(a) (holding unenforceable certain financing arrangements under a contract for the sale of property upon which the seller is liable for taxes if the sale was consummated "with intent to avoid such tax, or in fraud of the internal revenue laws"); § 7422(e) (providing, in the context of a civil action for refund, that the taxpayer has the burden of proof on all issues "except as to the issue of whether the taxpayer has been guilty of fraud with intent to evade tax"); § 7454(a) (similarly providing that "[i]n any proceeding involving the issue whether the petitioner has been guilty of fraud with intent to evade tax, the burden of proof in respect of such issue shall be upon the Secretary"); and § 7611(i)(4) (excepting from the general rule limiting inquiries into the tax-exempt status of churches "any willful attempt to defeat or evade any tax imposed by this title").

provisions, and not from the provisions relied upon by the Haas panel.

These numerous provisions — and others using similar language that we have not cited — argue against placing too much weight on the particular phraseology chosen by Congress. We do not mean to suggest that these provisions affirmatively disprove the reading of the Haas panel. Nor do we suggest that each of these provisions should be interpreted in the same way. We cite these provisions merely to demonstrate that the elimination of the phrase "or the payment thereof," which looks conspicuous when compared to the specific provisions that include that phrase, looks much less so when viewed in light of all of these provisions that differ in relatively minor ways.

This point is reinforced when one considers that the relevant phrase of § 523(a)(1)(C) was not enacted as part of the same statute as the sections including the phrase "or the payment thereof," and is not even part of the I.R.C., but is rather a provision of the Bankruptcy Code. The Haas panel acknowledged this point, but relied on the presumption that "Congress is . . . aware of pertinent, existing law when it passes legislation." See id. (citations omitted). We suggest that this presumption is relatively weak, however, when the background law is the entire I.R.C., which encompasses fifteen volumes of the United States Code Annotated, and which includes provisions that contain language referring both to the evasion of tax and to the payment thereof, but which also includes numerous provisions which refer only to the former. In short, we have some doubt about attaching too much significance to the lack of a four-word phrase in § 523(a)(1)(C).

Appendix B

III. CONCLUSION

For the foregoing reasons, we reverse the judgment of the district court on the basis of the holding in Haas and remand for further proceedings consistent with this opinion. However, we suggest that this case might warrant en banc reconsideration.

REVERSED and REMANDED.

APPENDIX C — PUBLISHED ORDER OF THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF FLORIDA AFFIRMING FINAL JUDGMENT OF THE BANKRUPTCY COURT DATED MARCH 26, 1997

In re Leroy Charles GRIFFITH,

Debtor.

Leroy Charles GRIFFITH,

Appellant,

v.

UNITED STATES of America,

Appellee.

No. 94-0147-CIV.
Bankruptcy No. 93-0361-BKC-AJC-A.

United States District Court,
S.D. Florida.

March 26, 1997.

* * *

ORDER AFFIRMING FINAL JUDGMENT
OF THE BANKRUPTCY COURT

Appendix C

NESBITT, District Judge.

THIS CAUSE came before the Court upon notification by Appellant, Leroy Charles Griffith, that the record, briefs, and a transcript of the oral argument may be relied upon for review of the merits of this appeal that was reassigned from the docket of deceased District Court Judge Sidney M. Aronovitz, in accordance with the Court's Order entered on February 21, 1997 and Administrative Order 97-03. Appellee, the United States of America, has not filed a response to the Court's Order.

The debtor appeals the bankruptcy court's Memorandum Decision and Judgment, determining that his federal income taxes for the years 1969-70, 1972-76, and 1978 are nondischargeable, pursuant to 11 U.S.C. § 523(a)(1)(C).

ISSUES

I. Appellant raises a procedural issue, that the bankruptcy court erred by permitting the government to amend its Answer to assert a counterclaim under 11 U.S.C. § 523(a)(1)(C). Granting leave to amend the pleadings is reviewed by this Court under the standard of abuse of discretion. Hargett v. Valley Fed. Sav. Bank, 60 F.3d 754, 760 (11th Cir.1995).

II. Appellant's assertions of substantive errors contend that the bankruptcy court's Opinion is based on an erroneous statutory interpretation of 11 U.S.C. § 523(a)(1)(C), and that there is an inadequate basis for the findings of fact in favor of the government. Interpretation of the statutory provision

is a question of law subject to de novo review. Haas v. Internal Revenue Service, 48 F.3d 1153, 1155 (11th Cir. 1995). The bankruptcy court's factual determinations are reviewed under the "clearly erroneous" standard. In re Goerg, 930 F.2d 1563, 1566 (11th Cir.1991).

FACTUAL AND PROCEDURAL BACKGROUND

Griffith filed his Chapter 7 bankruptcy petition on January 15, 1993. He filed a Complaint to determine the dischargeability of certain tax liabilities, asserting the provision of the Bankruptcy Code, 11 U.S.C. § 523(a), without further specification. The Answer filed by the United States was a general denial, also without reference to a specific statutory subsection. In a pretrial discovery motion, filed on June 29, 1993, the government raised the issue of the debtor's attempt to evade or defeat his tax liabilities.

At trial on July 28, 1993, the parties stipulated that the tax liabilities met the requirements for discharge under the provisions of Sections 507(a)(7)(A)(i) and (ii) and 523(a)(1)(B)(ii). The debtor rested his case, and moved for judgment or a directed verdict. The bankruptcy court allowed the government to amend its Answer to assert a counterclaim for nondischargeability pursuant to Section 523(a)(1)(C). At that time, the bankruptcy court offered Griffith the opportunity to have the trial continued, which Griffith declined. Following the presentation of evidence on the Section 523(a)(1)(C) dischargeability issue, the bankruptcy court ruled in favor of the government. The bankruptcy court found that Griffith attempted to evade and defeat taxes by concealing and transferring his assets to reduce the assets subject to IRS execution in order to defraud the IRS.

Appendix C

The factual basis for analyzing Griffith's transfer of assets was considered by the bankruptcy court in reference to the "badges of fraud". Griffith owned corporations that operated adult theaters. Transactions in cash were a common practice in the operation of his businesses. Griffith transferred to himself and his wife, Linda, as tenants by the entirety, his stock in two of the corporations, Ell Gee and Gayety, and promissory notes in the amount of $390,000. He also transferred assets from another corporation, Showcase, to Linda's corporation, NuWave. The transfers, through an antenuptial agreement, were made on June 8, 1989, the day Griffith married Linda. They entered into this marriage after maintaining a relationship and living together for at least ten years. This marriage occurred after the Tax Court had ruled nine months earlier that Griffith under-reported his income for 1969-1970, 1972-1976 and 1978.

The Tax Court found that Griffith was the sole shareholder of the corporations for the years in question. Griffith owed taxes in the amount of $1,984,121.66. On September 28, 1989, the IRS made assessments against Griffith for these taxes, and Griffith claimed he had no way of paying the amount that was due.

DISCUSSION

I. Amendment of Answer

Griffith argues that at the time of trial, he had no indication that Defendant was relying on Section 523(a)(1)(C). After Plaintiff rested, the Answer was amended to allege that provision as the basis for the government's

counterclaim. Factors for the exercise of discretion to allow an amendment of the pleadings are that: (1) the party has not unduly delayed; (2) the party is not acting in bad faith or with a dilatory motive; (3) the opposing party will not be unduly prejudiced; and (4) the amendment is not futile. Foman v. Davis, 371 U.S. 178, 182-83, 83 S.Ct. 227, 230, 9 L.Ed.2d 222 (1962); In re Ambulatory Medical & Surgical Health Care, Inc., 187 B.R. 888, 900 (Bankr.W.D.Pa.1995). Taking these factors into account, and considering that the bankruptcy court offered to continue the trial to allow Griffith more time to respond to the counterclaim and for additional discovery, this Court finds no abuse of discretion by the bankruptcy court in permitting the government to amend its Answer.

The bankruptcy court applied Bankr.Rule 7013 to allow the assertion of the counterclaim. There was no prejudice to Griffith under these circumstances, based on his having declined the offer of a continuance of the trial.

II. Substantive Issues Pursuant to Section 523(a)(1)(C)

The substantive issues concern the interpretation and application of Section 523(a)(1)(C), and whether the facts establish a basis to find the tax liabilities nondischargeable. Griffith relies on In re Haas, 48 F.3d 1153, 1158 (11th Cir.1995), to support his position that his liabilities should be discharged.

Appendix C

STATUTORY INTERPRETATION

Section 523(a)(1)(C) provides, in part, that:

> (a) A discharge under . . . this title does not discharge an individual debtor from any debt
>
> (1) for a tax . . .
>
> (C) with respect to which the debtor made a fraudulent return or willfully attempted in any manner to evade or defeat such tax. (Emphasis added).

Visiting Bankruptcy Judge Erwin Katz presided over the trial and entered the Memorandum Opinion which is the subject of this appeal. Cases are cited by the bankruptcy court holding that nonpayment of federal taxes which the taxpayer knows are owed is a ground for denying dischargeability of those taxes. This liberal interpretation was rejected by Haas, which was decided after Bankruptcy Judge Katz considered the issues in Griffith's adversary proceeding.

In Haas, the Eleventh Circuit referred to the distinction between evading the assessment and the payment of taxes, and held that "a debtor's failure to pay his taxes, alone, does not fall within the scope of Section 523(a)(1)(C)'s exception to discharge in bankruptcy." 48 F.3d at 1158.

The bankruptcy court determined that Griffith carried out a plan through concealment and transfers of assets in order to defraud the IRS. The bankruptcy court found that

Appendix C

Griffith's antenuptial agreement was not a mutual exchange, as his wife gave up nothing of value. Griffith's conduct in making the transfers had the natural consequence of failing to pay the taxes, and the bankruptcy court did refer to this as attempting to evade and defeat the payment of taxes. The bankruptcy court also based its decision on the plan carried out by Griffith, the surrounding circumstances and the evidence under the "badges of fraud".

Haas recognizes that "honest debtors may fail to pay their properly acknowledged taxes." Id. The Court in Haas makes reference to the bankruptcy court's decision in Griffith as being unpersuasive. In Haas, the government argued a very broad interpretation of Section 523(a)(1)(C), so that mere failure to pay the tax would constitute proof of evasion of tax debts. The Eleventh Circuit rejected that reading of the statute, which would effectively make all tax debts nondischargeable. Id. at 1155-56. It is significant that the government has taken a much narrower approach in arguing this appeal than it had pursued in Haas.

The facts in Haas are distinguishable from Griffith's case, where Haas did not engage in dubious transfers of assets, but Griffith clearly has done so. Id. at 1154 n. 2. Griffith's situation does not reflect poor financial management, as in In re Sonnenberg, 148 B.R. 35 (Bankr. N.D.Ill.1992), cited in Haas at 1156 n. 4.

Griffith's transfer of assets constitutes more than mere nonpayment. The bankruptcy court's analysis includes Griffith's conduct of evading payment as part of the totality of the circumstances to determine whether or not Griffith

willfully attempted to evade or defeat taxes. See Dalton v. I.R.S., 77 F.3d 1297, 1301 (10th Cir.1996); Commissioner v. Peterson, 152 B.R. 329, 335 (D.Wyo.1993). This Court concludes that the factual findings of Griffith's intentional plan involved more than allocating his assets to liabilities other than taxes. See In re Williams, 186 B.R. 521, 522 (M.D.Fla.1995) (applying Haas). Griffith's conduct is in contrast to innocuous behavior such as merely using income to pay debts other than his tax liability. The debtor's transfer of assets to his wife through the antenuptial agreement is more aptly described as lacking in substance and based on a fraudulent intent.

EVIDENTIARY BASIS FOR FINDINGS

Griffith also contends that the evidence does not support a finding that the government met its burden of proof of a willful attempt to evade taxes. Appellant asserts the lack of "badges of fraud," and the specific finding of the Tax Court that the payment of personal expenses by Griffith's corporations was not fraudulent. Additional facts set forth by Griffith are that he made settlement offers, filed tax returns, was willing to obtain third-party funding, did not use a shell corporation to avoid government detection, and harbored no evil motive in transferring his corporate stock. Appellant would have this Court conclude that the bankruptcy court erred in determining nondischargeability because Griffith's conduct was merely that he did not pay the taxes.

The types of conduct from which a willful attempt to defeat or evade taxes may be inferred may include any

conduct the likely effect of which would be to mislead or conceal. See Spies v. United States, 317 U.S. 492, 63 S.Ct. 364, 87 L.Ed. 418 (1943). The bankruptcy court found that Griffith conducted his financial affairs through "corporate legerdemain," evaded his personal obligations through a pattern of personal-corporate commingling of funds, made transfers for inadequate consideration, with a state of mind to willfully evade and defeat his tax obligations, and that Griffith lacked credibility as a witness.

The nature of this analysis is factual, determined from the totality of the record. See Williams, 186 B.R. at 522. The bankruptcy court's findings concerning Griffith's conduct of transferring assets and his intent are not clearly erroneous, and the conclusion drawn from those facts is not an error of law, pursuant to the standard in Haas, that Griffith's tax debts are not dischargeable.

CONCLUSION

Upon a thorough review of the record, the briefs, transcript and argument presented by the parties, this Court finds that: (1) the bankruptcy court did not abuse its discretion by permitting the government to amend its Answer; (2) the factual findings of the bankruptcy court are not clearly erroneous; and (3) the bankruptcy court's analysis of the facts demonstrates that Griffith engaged in a fraudulent plan to evade or defeat taxes.

Griffith did not merely fail to pay his taxes, alone, and, therefore, his taxes are nondischargeable, consistent with the

analysis of Haas, which is binding authority on this Court. For the foregoing reasons, it is

ORDERED AND ADJUDGED that the Memorandum opinion and Judgment of nondischargeability of taxes owed by Leroy Charles Griffith, entered by the bankruptcy court on December 9, 1993, is AFFIRMED.

APPENDIX D — PUBLISHED FINDINGS OF FACT, CONCLUSIONS OF LAW AND MEMORANDUM OPINION OF THE UNITED STATES BANKRUPTCY COURT FOR THE SOUTHERN DISTRICT OF FLORIDA DATED DECEMBER 9, 1993

In re Leroy Charles GRIFFITH,

Debtor.

Leroy Charles GRIFFITH,

Plaintiff,

v.

UNITED STATES of America,

Defendant.

Bankruptcy Nos. 93-10148-BKC-AJC, 93-0361-BKC-AJC-A.

United States Bankruptcy Court, S.D. Florida.

Dec. 9, 1993.

* * *

FINDINGS OF FACT, CONCLUSIONS OF LAW AND MEMORANDUM OPINION[1]

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1. Judge Erwin I. Katz, United States Bankruptcy Judge, Northern District of Illinois, is sitting by Special Designation in this case in the Southern District of Florida.

Appendix D

ERWIN I. KATZ, Bankruptcy Judge, sitting by special designation.

This adversary proceeding comes before the Court on the complaint of Leroy Charles Griffith ("Griffith") to determine the dischargeability of his federal income tax debt. After considering the arguments and evidence presented, the Court enters these Findings of Fact and Conclusions of Law. This is a core proceeding over which the Court has subject matter jurisdiction pursuant to 28 U.S.C. §§ 1334 and 157(b)(2)(I).

BACKGROUND

Griffith owned entertainment theaters since the early 1960's. Griffith used several corporate entities to control the theaters. These entities include, but are not limited to:

. Gayety Theaters, Incorporated: Shareholders are Linda Rivera Griffith ("Linda") and Griffith, held as tenants in the entirety, pursuant to the antenuptial contract between Linda and Leroy dated June 8, 1989. Griffith testified that prior to June 8, 1989, the stock was divided between Griffith, his son, his father, and Linda. The Tax Court, however, found that Griffith was the sole shareholder in the years in question.[2]

. Ell Gee, Incorporated: Shareholders are Linda and Griffith, held as tenants in the entirety,

2. See the discussion of the Tax Court opinion, infra p. 730.

pursuant to the antenuptial contract between Linda and Griffith dated June 8, 1989. Griffith testified that prior to June 8, 1989, the stock was divided between Griffith, his son, his father, and Linda. The Tax Court, however, found that Griffith was the sole shareholder in the years in question.[3]

. Nu-Wave, Attractions, Incorporated: Linda is the only shareholder but Griffith is an officer: Nu-Wave owns real estate used in Griffith's businesses.

No evidence was presented regarding what each of these businesses controlled. Griffith signed checks on the accounts of all the corporations.

Griffith did not have a personal checking account, but used these corporate entities to pay his personal expenses. Griffith did not own a car or a house but drove a car owned and depreciated by Gayety and rented a house in Miami which was owned and depreciated by Gayety. Griffith paid $1,200 a month rent on the house by increasing the open loan account he maintained with Gayety. Griffith testified he would use his income from the corporations to pay down these loans when possible.

It was not uncommon for Griffith to withdraw large amounts of cash from the accounts of all the corporations. The nature of Griffith's business made it important that a paper trail not be created, so cash was often used in business

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3. See the discussion of the Tax Court opinion, infra p. 730.

transactions. Leftover cash was spread back into the accounts in a manner to keep their balances above zero. Overdrafts were common in the accounts so Griffith transferred money between Ell-Gee and Gayety to keep the balances above zero to avoid overdraft charges.

The Internal Revenue Service (hereinafter "IRS") audited Griffith in regard to the tax years 1969-1970, 1972-1976, and 1978. The IRS found Griffith understated his tax liability and owed back taxes along with interest and penalties. The Tax Court, in an eighty-six page opinion dated September 19, 1988, found Griffith's practice of having Gayety deduct depreciation for Griffith's residence was not proper, but was not fraudulent. Griffith testified he read this opinion.

NuWave was incorporated October 10, 1988. Linda owned all the stock but did not receive a salary. Griffith took care of the day-to-day operations. Gayety and NuWave maintained checking accounts at Capital Bank. Capital Bank would cash Griffith's checks without question, i.e. Griffith cashed a $25,000 check from NuWave on June 15, 1992. Griffith signed the required federal form for that transaction as the owner of NuWave. On December 31, 1992, Show World, one of Griffith's corporations, went out of existence and its assets, which consisted mainly of real estate, were merged into NuWave.

On June 8, 1989, Linda and Griffith were married after having lived together for at least ten years. On this same day, they entered into an antenuptial agreement. Pursuant to that agreement Griffith assigned his capital stock in Gayety,

Ell-Gee and Paris Follies, Inc. along with approximately $390,000 in promissory notes from his son and Linda, to Linda and himself as tenants by the entirety. In exchange, Linda relinquished all potential claims against the future earnings of Griffith. Griffith testified he did not make this agreement with the intent of frustrating the government's efforts to collect his tax debt, but failed to provide any explanation for this transfer.

On September 28, 1989, the IRS made an assessment against Griffith. In 1991, the IRS assigned Linda Simmons, a revenue officer for the IRS, to collect Griffith's taxes. She learned Gayety was Griffith's employer from his 433(a) form, a collection information statement for individuals, signed by Griffith under penalty of perjury. When she attempted to serve the levy on Gayety in May 1991, Griffith told her he did not receive a salary from Gayety and he referred her to his attorney. At trial, he testified he may have received one or two checks after the IRS levied. Simmons testified she did not find any evidence Griffith received a salary.

Simmons testified that she reviewed various records of the corporations. Her review reflected that Ell-Gee deposited $782,934.36 at Capital Bank between December 31, 1991 and January 1993, Gayety deposited $335,775.33 at Capital Bank between May 31, 1992 and January 31, 1993, and NuWave deposited $748,598.04 at Capital Bank between December 31, 1991 and January 1993. Some of these deposits may have been circular, from Ell-Gee to Gayety and vice-versa, to inflate balances to avoid overdraft charges. Simmons testified that the tax returns for Ell-Gee, Gayety and Nu-Wave in 1988, 1989 and 1990 each reflected a loss.

No payments have been made on the tax debt. The balance due of the tax debt as of the petition date, including interest and penalties, totals $1,984,121.66. Griffith testified he is aware of the debt but has no way to pay it. Griffith testified he attempted to settle this debt several times and that he gave his attorney authority to settle this debt. No specific settlement attempts or terms were disclosed.

ALLOWANCE OF THE COUNTERCLAIM

On January 15, 1993, Griffith filed a voluntary Chapter 7 bankruptcy petition. On or about April 17, 1993, Griffith initiated this Adversary Proceeding seeking a determination that his debt to the IRS was not excluded from discharge by § 523(a)[4] or any other provision of law. In its Answer, the IRS denied that Griffith's tax debt was dischargeable. When the case was called to trial on July 28, 1993, Griffith's attorney submitted a stipulation to the Court wherein the IRS stipulated that the tax liability was dischargeable under §§ 507(a)(7)(A)(i) and (ii) and 523(a)(1)(B)(ii). Griffith's attorney then rested his case and moved for judgment in his favor. This Court granted the IRS' ore tenus motion to amend its Answer and assert a counterclaim setting forth that the debtor's tax liability is excepted from discharge under § 523(a)(1)(C) because Griffith attempted to evade or defeat his tax liability. The IRS claimed that Griffith's actions whereby he entered into an antenuptial agreement which transferred assets out of the IRS' reach, structured his corporations to own his residence and car in order to keep them from the IRS' grasp and took no salary or other

4. All references herein are to the Bankruptcy Code, 11 U.S.C., unless otherwise noted.

remuneration from corporations which he controlled, were efforts to evade or defeat the payment of taxes. Griffith argues that this Court erred by permitting the IRS to amend its answer and assert § 523(a)(1)(C) as a counterclaim.

The burden of proving that the debtor's tax liabilities are nondischargeable under § 523(a)(1)(C) is on the IRS. In re Berzon, 145 B.R. 247 (Bankr.N.D.Ill.1992); In re Fernandez, 112 B.R. 888 (Bankr.N.D.Ohio 1990); In re Kirk, 98 B.R. 51 (Bankr.M.D.Fla.1989). In the instant case, the IRS denied Griffith's debt was dischargeable, citing § 523(a). Both Griffith and the IRS failed to refer specifically to § 523(a)(1)(C), in the Complaint or Answer, nor was § 523(a)(1)(C) pled as a counterclaim or an affirmative defense, as required by Bankruptcy Rule 7008(a).[5] When Griffith failed to specify the subsections of § 523(a) being relied upon, the IRS should have moved for a more definite statement under Bankruptcy Rule 7012(e). The ambiguity created by the pleadings was perpetuated by both Griffith and the IRS.

Bankruptcy Rule 7015 provides that leave to amend pleadings "shall be freely given when justice so requires." Bankruptcy Rule 7013(f) provides that "[w]hen a pleader fails to set up a counterclaim through oversight, inadvertence, or excusable neglect, or when justice requires, the pleader may by leave of court set up the counterclaim by amendment."

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5. Rule 7008(a) requires that a plea in the nature of an avoidance must be asserted as an affirmative defense.

Appendix D

A party may amend if "(1) [it] has not unduly delayed, (2) [it] is not acting in bad faith or without dilatory motive, (3) the opposing party will not be unduly prejudiced by the amendment, and (4) the amendment is not futile." Storwal Intern., Inc. v. Thom Rock Realty Co., L.P., 784 F.Supp. 1141 (S.D.N.Y.1992). Griffith argues the IRS unduly delayed in bad faith by waiting until the trial had commenced before attempting to amend. Griffith was put on notice that the IRS was using § 523(a)(1)(C) as a defense at least as early as June 29, 1993, when the IRS noted in its Motion To Reopen Discovery that it (the IRS) was defending against the complaint based on § 523(a)(1)(C). The Court notes that § 523(a), without further specification, was referenced in Griffith's complaint. The Complaint, therefore, placed into issue all of the elements of § 523(a), including § 523(a)(1)(C). The answer did not add any specificity. As previously discussed the parties should have better defined the issues in their pleadings. However, the Court does not find this answer to be made with bad motive.

Griffith argues he was unduly prejudiced by the amendment. Griffith's attorneys argue they relied on the IRS' failure to amend prior to trial, and therefore failed to anticipate having to defend against such an argument. The reliance argument is somewhat weakened by the pre-trial motion history. The Court notes that the issues were argued in the Motion to Reopen Discovery, filed on June 29, 1993. The record will further reflect that at the outset of the trial the Court extended to Griffith the option to continue the trial date and allow further discovery as well as time to prepare additional defenses. Griffith declined the offer. The claim of surprise was waived. The Court does not find Griffith was prejudiced by allowing this amendment.

Finally, this amendment was not futile. This amendment was necessary due to poor pleading, and § 523(a)(1)(C) is the only issue in this case.

COLLATERAL ESTOPPEL

Griffith argues the IRS is collaterally estopped by the Tax Court's determination issued September 19, 1988. The Eleventh Circuit has "affirmed the use of collateral estoppel in dischargeability proceedings." In re Powell, 95 B.R. 236, 238 (Bankr.S.D.Fla.1989); see In re Latch, 820 F.2d 1163 (11th Cir.1987); In re Halpern, 810 F.2d 1061 (11th Cir.1987). In order for collateral estoppel to be applied in dischargeability proceedings, three elements must be present:

> (1) the issue at stake must be identical to the one involved in the prior litigation;
>
> (2) the issue must have been actually litigated in the prior litigation; and
>
> (3) a determination of the issue in the prior litigation must have been a critical and necessary part of the judgment in that earlier action.

Id. at 238.

The burden of proof standards are not the same. The Tax Court used "clear and convincing evidence" as the standard to determine whether Griffith was liable for fraud. In this proceeding "preponderance of the evidence" is the standard. Grogan v. Garner, 498 U.S. 279, 111 S.Ct. 654,

112 L.Ed.2d 755 (1991). Secondly, the Tax Court only considered whether Griffith fraudulently under-reported his income tax for the years 1969-1970, 1972-1976 and 1978. The allegations in this case refer to actions taken after the entry of the Tax Court decision in an attempt to evade or defeat the payment of the tax liabilities imposed by the Tax Court. Accordingly, the issue at bar is not the same issue decided by the Tax Court.

DISCHARGEABILITY

The burden of proving that the debtor's tax liabilities are nondischargeable is on the IRS. In re Fernandez, 112 B.R. 888 (Bankr.N.D.Ohio 1990); In re Kirk, 98 B.R. 51 (Bankr.M.D.Fla.1989). The IRS must prove nondischargeability by a preponderance of the evidence. Grogan v. Garner, 498 U.S. 279, 111 S.Ct. 654, 112 L.Ed.2d 755 (1991). Thus, the IRS will meet its burden if it shows that it is more probable than not that Griffith willfully attempted to evade his taxes. In re Berzon, 145 B.R. 247, 250 (Bankr.N.D.Ill.1992).

Section 523

Section 523 of the Bankruptcy Code provides that certain tax debts are not dischargeable in a Chapter 7 case. The language in § 523 that is relevant to the instant dispute is:

> [a] discharge under section 727 . . . of this title does not discharge an individual debtor from any debt . . . for a tax . . . with respect to which the debtor made a fraudulent return or willfully attempted in any manner to evade or defeat such tax;

11 U.S.C. § 523(a)(1)(C).

Appendix D

Does Section 523(a)(1)(C) Cover the Evasion of the Payment of Taxes?

The IRS does not claim that Griffith made a fraudulent return. Rather, IRS asserts that Griffith's tax liability, as determined by the Tax Court, is non-dischargeable due to Griffith's actions in attempting to place his assets beyond the reach of the IRS.

The case law has not come to a consensus on whether § 523(a)(1)(C) covers the evasion of the payment of taxes. One line of reasoning looks to the similar language used in § 7201 of the Internal Revenue Code ("IRC"), 26 U.S.C. § 7201, a criminal statute, to provide guidance. See In re Gathwright, 102 B.R. 211 (Bankr.D.Ore.1989), wherein that court reasoned that since IRC § 7201 specifically provides that it is a felony to willfully attempt to evade or defeat any tax or the payment thereof, and § 523(a)(1)(C) does not have the phrase "or payment thereof," found in IRC § 7201, § 523(a)(1)(C) does not extend to actions to evade or defeat the payment of a tax.

This Court disagrees with Gathwright. This Court follows the reasoning of In re Jones, 116 B.R. 810 (Bankr.Kan.1990) and In re Berzon, 145 B.R. 247 (Bankr.N.D.Ill.1992) to reject Gathwright. Section 523(a)(1)(C) is to be read in the disjunctive. In re Gilder, 122 B.R. 593, 595 (Bankr.M.D.Fla.1990). The Court finds the modifying phrase of § 523(a)(1)(C), "in any manner," is sufficiently broad to include willful attempts, like Griffith's, to evade taxes by concealing and transferring assets to protect them from execution or attachment.

Appendix D

What Is Meant By Willful As Used In 523(a)(1)(C)?

Griffith argues that willful as used in § 523(a)(1)(C) should be defined in accordance with the substantially similar criminal IRC § 7201[6] which courts have held requires an affirmative act of fraud with an evil motive. See Darrell Dunhaham & Alex Shimkus, Tax Claims in Bankruptcy, 67 Am.Bankr.L.J. 343, 384 (1993). The IRS counters by arguing the court should not be guided by IRC § 7201 but IRC § 6653[7], a civil section that does not require an affirmative act. In the alternative, the IRS argues the Court should follow the Court in Berzon and Cinquegrani v. United States, 1993 WL 134752 (Bankr.N.D.Ill. Feb. 1, 1993), and look to the "badges of fraud" to infer fraudulent intent and not solely look for an affirmative act of fraud.

This Court finds willful should be read in accordance with other civil sections. The Court will follow the principle that "in criminal statutes willfulness generally requires bad purpose or the absence of any justifiable excuse . . . In civil actions, however, these elements need not be present. Rather, willful conduct denotes intentional, knowing and voluntary acts." Monday v. United States, 421 F.2d 1210 (7th Cir.),

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6. IRC § 7201 states:

> Any person who willfully attempts in any manner to evade or defeat any tax imposed by this title or the payment thereof shall . . . be guilty of a felony. . . .

7. IRC § 6653 does not define fraud. Case law has determined the appropriate definition of fraud in reference to § 6653.

cert. denied, 400 U.S. 821, 91 S.Ct. 38, 27 L.Ed.2d 48 (1970). This same view of "willful" was recently upheld in Domanus v. United States, 961 F.2d 1323, 1326 (7th Cir.1992). Other courts have reached the same conclusion. See In re Gilder, 122 B.R. 593, 595 (Bankr.M.D.Fla.1990); In re Kirk, 98 B.R. 51, 55 (Bankr.M.D.Fla.1989); U.S. v. Toti, 149 B.R. 829 (E.D.Mich.1993); In re Fernandez, 112 B.R. 888 (Bankr.N.D. Ohio 1990); In re Langlois, No. 91- 91194 (Bankr.S.D.N.Y. 1992); In re Jones, 116 B.R. 810, 815 (Bankr.Kan.1990).

The Court may use various kinds of circumstantial evidence to infer fraudulent intent since direct evidence of such an intent rarely exists. Berzon, 145 B.R. at 250; Cinquegrani 1993 WL 134752 at *5; Hagaman v. Commissioner [92-1 USTC P 50,141], 958 F.2d 684, 696 (6th Cir.1992); Bradford v. Commissioner [86-2 USTC P 9602], 796 F.2d 303, 307-08 (9th Cir.1986); Loftin and Woodard, Inc. v. United States [78-2 USTC P 9645], 577 F.2d 1206, 1238-39 (5th Cir.1978). These "badges of fraud" include: (1) the recurrence of the understatement of income for more than one tax year; (2) the understatement of income; (3) implausible or inconsistent explanations of behavior; (4) inadequate records; (4) transfer of assets to a family member; (5) transfer for inadequate consideration; (6) transfer that greatly reduced assets subject to IRS execution; and (7) transfers were made in the face of serious financial difficulties. Eyler v. Commissioner, 760 F.2d 1129 (11th Cir.1985); Douge v. Commissioner [90-1 USTC P 50,186], 899 F.2d 164, 168 (2d Cir.1990); Bradford [86-2 USTC P 9602], 796 F.2d at 307- 08; Loftin and Woodard [78-2 USTC P 9645], 577 F.2d at 1238-39. Griffith argues he did not conceal assets, making his case factually distinguishable

from the debtors in Jones[8] and Berzon[9]. The Court does not agree.

Parenthetically, the Court notes those issues which have not been raised by the IRS. The IRS is not claiming in this proceeding that any action by Griffith before the date of the Tax Court decision constituted a non-dischargeable attempt to evade or defeat any tax. Nor does this proceeding involve income or taxes for any years after 1978. Thus the narrow question before this Court is whether the IRS has shown, by a preponderance of the evidence, that Griffith has willfully attempted to evade or defeat the tax liability for the tax years 1969-70, 1972-76 and 1978 as determined by the Tax Court decision of September 19, 1988.

The seeds for Griffith's plan to evade the tax owed to the IRS were conceived once the Tax Court issued its determination in September 1988. After a gestatory period, nine months later, in June 1989, after living together for more than ten years, Griffith and Linda were married and begat the antenuptial agreement. Griffith asserts that the antenuptial agreement was an arms length mutual exchange wherein both parties gave up some rights and acquired others. In reality, Linda gave up her rights to make claims in the future against Griffith or his estate, but these claims were de minimis. At that time, Griffith owed the IRS a significant amount of money. His businesses had not made a profit in a number of

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8. The debtor placed title to their home and lake property in names of others in order to evade taxes.

9. The debtor significantly misrepresented his income by depositing his wages into his girlfriend's bank account.

years and had no prospects of reversing this losing trend. The promissory notes assigned to Linda totalling approximately $390,000 were all notes wherein the obligor was either Griffith's son or Linda. In return, Linda received, not in her sole name but as a tenant in the entirety with Griffith[10], stock in these corporations which had little value due to the continuing losses of these corporations. This was an exchange to a family member, during a period of serious financial difficulty, for inadequate consideration to evade and defeat payment to the IRS.

Griffith's corporate legerdemain standing by itself would be insufficient to establish evasion under § 523(a)(1)(C). However, while Griffith's pattern of personal-corporate commingling of funds were similar in both pre-1988 and post-1988 years, they reflect his intent to evade meeting his personal obligations. The "badges of fraud" identified in the case law are simply factors taken into consideration by various courts attempting to ascertain a state of mind. The Court notes further that Griffith's manner as a witness, as well as that of his wife, was evasive and lacked that ring of forthrightness reflective of an open and credible witness.

Griffith also argues that the reasoning of the IRS would mean that filing bankruptcy would be considered an effort to evade taxes under § 523(a)(1)(C), resulting in taxes never being dischargeable. Both the Tax Code and the Bankruptcy

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10. By holding title to these assets as tenants in the entirety, the IRS could not levy against these assets unless it (the IRS) had judgments against both Linda and Griffith. See Matter of Geoghegan, 101 B.R. 329 (Bankr.M.D.Fla.1989); U.S. v. One Single Family Residence, 894 F.2d 1511 (11th Cir.1990).

Code provide for acceptable means to lessen or discharge tax liability. The evade and defeat provision of § 523(a)(1)(C) is not one of them. The Bankruptcy Code in § 507(a)(7) has specific guidelines that determine when tax debts are dischargeable.

Finally, Griffith emphasizes that he made several attempts to settle this debt with the IRS, demonstrating he was not attempting to evade this debt. Griffith testified he attempted to settle this debt but he could not recall any specifics regarding his attempts. There is no other evidence of any attempts to settle this debt. Accordingly, the Court gives little value to Griffith's testimony that he attempted to settle this debt with the IRS.

Looking at the surrounding circumstance, the Court finds Griffith willfully attempted to evade and defeat paying the taxes due. The transfers under Griffith's antenuptial agreement were an attempt to willfully evade and defeat the payment of taxes. Griffith alleges the antenuptial agreement was a mutual exchange but, as explained previously, Linda gave up, and received nothing of value in order to help Griffith keep assets from the reach of the IRS. The antenuptial transfer was an act intentionally undertaken in the face of a large debt, to a family member, which greatly reduced the assets subject to IRS execution in order to defraud the IRS. Further, the transfer of assets from Showcase, a Griffith corporation, to NuWave, Linda's corporation, demonstrates intent to keep assets out of the reach of the IRS. Accordingly, Griffith had specific intent to willfully evade and defeat a tax he knew was due and owing.

Appendix D

CONCLUSION

For the reason stated herein, the Court finds Griffith's debt to the IRS is nondischargeable according to § 523(a)(1)(C).

APPENDIX E — PUBLISHED MEMORANDUM FINDINGS OF FACT AND OPINION OF THE UNITED STATES TAX COURT DATED AND FILED SEPTEMBER 19, 1988

T.C. Memo. 1988-445

UNITED STATES TAX COURT

LEROY C. GRIFFITH,

Petitioner

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent

Docket Nos. 22089-80, 4032-85. Filed September 19, 1988.

* * *

MEMORANDUM FINDINGS OF FACT AND OPINION

PARR, *Judge*: In his 121 page statutory notice respondent determined the following deficiencies against petitioner individually:

Appendix E

Year	Deficiency	Sec. 6653(b)[1] Additions to Tax
1969	$ 60	$ 30
1970	60	30
1972	25,968	12,984
1973	3,136	1,568
1974	105,947	52,974
1975	148,429	74,215
1976	137,275	68,638
1977	73,983	36,992
1978	122,937	61,469

Several years later respondent determined the following deficiencies against petitioner as transferee of GTI Productions, Inc. (sometimes hereinafter GTI):[2]

Year Ending	Deficiency	Sec. 6653(b) Addition to Tax
March 31, 1975	$35,283	$18,251
March 31, 1976	48,532	24,266
March 31, 1977	20,051	10,026

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1. Unless otherwise indicated, all section references are to the Internal Revenue Code applicable to the year at issue and all Rule references are to the Tax Court Rules of Practice and Procedure.

2. For convenience docket No. 22089-80, the case involving petitioner's individual tax liability, and docket No. 403[illegible]65, the case involving petitioner's tax liability as transferee of GTI were consolidated for trial, briefing and decision.

Appendix E

After concessions,[3] we must decide the following issues:[4]

1. Whether the Forms 872 signed by petitioner's accountant effectively extended the statute of limitations for

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3. In his Reply Brief, filed May 27, 1987, respondent made the following concessions:

	1974	1975	1976	1977	1978
Depr. for automobiles	$2,293	$2,293	$2,293		
Contract labor		1,075	1,250	$400	$1,000
Freight expenses	720				
Loss (Paris Follies)*		15,470			
Legal Fees		2,250	4,000	2,000	
Travel & Entertainment*				9,649	
Expenses for Operating Climax Theater*			8,118		
Loss (Ell Gee, Inc.)				14,237	

No income from relief of indebtedness for Ell Gee, Inc. $13,851 No year indicated.

In addition respondent conceded that GTI's checking account was used by petitioner to pay expenses for other corporations after GTI went out of business and therefore petitioner is allowed the following deductions:

1975	1976	1977
$775	$13,467*	$2,000

* Figures have been rounded to the closest dollar amount.

4. There are numerous items of income and deductions at issue. For clarity and conciseness, the particular items appear in appendices

(Cont'd)

the assessment and collection of tax for the 1974 and 1975 taxable years;

2. Whether petitioner has substantiated his entitlement to: (a) deductions respondent disallowed,[5] (b) unclaimed deductions asserted in an amendment to his petition, and (c) additional deductions for amounts which were miscategorized as travel and entertainment expenses;

3. Whether petitioner has realized additional income (apart from the disallowed deductions): (a) from Bee Gee, Inc. in 1974 and 1975, in the amounts of $4,400 and $21,700; from Cameo Productions in the amounts of $2,097, and $3,100 in 1975 and 1976, respectively; and $3,262 from the

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(Cont'd)
attached to the opinion. Appendix A sets forth the adjustments respondent made in his statutory notice of deficiency. Appendix B sets forth the items of disallowed deductions and previously unclaimed deductions. Appendix C sets forth the outstanding balances in loan accounts between petitioner and his corporations.

5. Included within the disallowed deductions were petitioner's claimed travel and entertainment expenses. The issue of travel and entertainment expenses is exceedingly convoluted. Respondent has disallowed all travel and entertainment except certain expenses associated with the operation of Climax Theater in North Carolina. All of the rest of petitioner's expenses claimed as travel and entertainment are still at issue, as is $599.48 associated with the operation of the Climax Theater. Moreover, petitioner now claims that many of the travel and entertainment expenses were erroneously deducted as such but that they were nevertheless deductible. To the extent petitioner concedes that expenses were miscategorized they are disallowed as travel and entertainment expenses.

Flamingo Theater in 1976, (b) from dividends received from GTI Productions, Inc. in 1974 and 1975 in the respective amounts of $8,254 and $38,947, and (c) from the return of a security deposit on the Paramount Theater in 1977;

4. Whether petitioner has substantiated Gayety Theater's entitlement to depreciation, maintenance and repair deductions for the residence at 4460 Bay Point Rd., Miami, Fla.;[6]

5. Whether petitioner's basis in Paris Follies, Inc. is increased by shareholder loans, thereby entitling petitioner to loss deductions in 1975 and 1976;

6. Whether petitioner is entitled to head of household filing status and income averaging for all the years in issue;

7. Whether petitioner is entitled to carrybacks in 1969, 1970, 1971 and 1973 and to carryforwards in 1976 and 1978;

8. Whether petitioner sustained additional deductible losses on the liquidation of Ninth Street Amusements, Inc., Adam and Eve Theaters, Inc. and Carib Theater Productions, Inc.;

9. Whether petitioner is liable as transferee of GTI Productions, Inc.; and

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6. Petitioner argues on brief that in the event we find that Gayety Theaters is not entitled to deductions at 4460 Bay Point Rd., petitioner would be entitled to deductions for interest and taxes.

10. Whether petitioner is liable for fraud both individually and as transferee of GTI Productions, Inc. for all the years in question.

GENERAL FINDINGS OF FACT

The parties to these cases have submitted 122 pages of stipulated facts in the form of a stipulation, a supplemental stipulation and a second supplemental stipulation. To the extent stipulated, those facts along with the related exhibits, are found, and incorporated herein by this reference. Many of the more important stipulated facts as well as the Court's additional findings are set forth below. The background section introduces the many people involved in this complex array of transactions and the business structure (to the extent possible) of the numerous theaters and corporations operated by petitioner.[7] Thereafter, each issue is discussed separately with more specific findings set forth as necessary.

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7. The Court has taken much time trying to decipher what transpired in petitioner's businesses between 1974 and 1978. The parties have submitted hundreds of pages of evidence and briefs to support their respective positions. Unfortunately, neither party took much time to convey to the Court which specific exhibits and which witnesses' testimony supported their positions. On numerous occasions we were required to review the over 200 exhibits to determine whether any of the documentary evidence supported either petitioner's or respondent's claim. Needless to say there are gaps as to what transpired in petitioner's businesses during the years in issue. We have, however, done the best we could with the limited guidance offered by the parties.

Appendix E

Background

Petitioner lived in Florida when he filed his individual original petition and his petition as transferee of GTI Productions.

Petitioner is in his mid-fifties and has a sixth-grade education. Petitioner started in the theater business when he left school in 1949. He began as a projectionist, cashier and usher at the local theater in his hometown. A short time later he worked concessions for Oscar Markovich at the Grand Theater in St. Louis, Mo. Petitioner was drafted into the armed services in 1955. After an early discharge he opened his first theater in Portland, Ore. The theater only stayed open a short time. After limited operation of a restaurant in Kansas City, Mo. and another period of short term employment with Oscar Markovich, petitioner opened a theater in Detroit, Mich. Three or four years later, in 1962, petitioner moved to South Florida where he started the conglomerate of entities involved in these cases.

During the years in question, petitioner was the sole shareholder of six electing small business ("subchapter S") corporations and two regular ("C") corporations. Most of the corporations operated more than one theater.

Petitioner's business was devoted primarily to providing "adult" entertainment, although a few of petitioner's theaters provided burlesque and vaudeville type shows. All of petitioner's subchapter S corporations and one of his C corporations operated movie and/or live theaters. The other C corporation, GTI Productions, Inc., was formed to purchase films and rent or resell them to the theaters petitioner operated.

Appendix E

The following is a summary of the corporations wholly owned by petitioner and the theaters each corporation operated at some time between 1974 and 1978.

Gayety Theaters, Inc. (Gayety), a subchapter S corporation, operated the Gayety Burlesque Theater, the Pussycat Theater and the Kittycat Theater all located in Miami, Fla.

Ell Gee, Inc. (Ell Gee), a subchapter S corporation, operated the Roxy Theater in Miami Beach, Fla., the Luv Theater in Orlando, Fla. and the Navy Point Theater in Pensacola, Fla.

Paris Follies, Inc. (Paris Follies), a subchapter S corporation, operated the Paris Follies Theater in Miami Beach, Fla., the Pussycat Theater (a/k/a Sinerama) in New Orleans, La. and the Capital Theater in Chattanooga, Tenn.

L. C. Griffith Productions, Inc. (L.C. Griffith), a subchapter S corporation, operated the Ritz Theater in Miami, Fla.

Griffco, Inc., a subchapter S corporation, operated the Paramount Theater in Miami, Fla., the New Carrolton Theater in New Orleans, La., the Cameo Theater in Miami Beach, Fla.[8] and the Climax I and II in North Carolina.

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8. Cameo Productions, Inc. was a separate subchapter S corporation which operated the Cameo Theater in Miami Beach, Fla. until 1975. Before 1975 Cameo Productions, Inc. had more than one shareholder. In 1975 petitioner became its sole shareholder, and Cameo Theater was then operated by Griffco.

Appendix E

Carib Theater Productions, Inc., a subchapter S corporation, operated the Carib Theater in Miami, Fla.

Adam & Eve Theaters, Inc., a C corporation, operated a theater of the same name in Ft. Lauderdale, Fla.

GTI Productions, Inc., a C corporation, organized to purchase films and rent them or sell them to petitioner's other corporations filed its last corporate income tax return on March 31, 1975. GTI Productions, Inc. filed no Federal income tax return for any subsequent fiscal years. On December 1, 1977, the State of Florida canceled GTI's corporate charter for "nonpayment of the 1977 annual report."

Petitioner had a few key employees who helped him run this enormous business. Harriet Miltenberg was petitioner's secretary during most of the years in question. She wrote out checks for the daily expenses of each of the theaters and petitioner signed them. Otherwise, she wrote checks only at the direction of petitioner and his accountant, Richard Reisenberg. Only petitioner had signatory authority.

George Luther was petitioner's "number two" man. When petitioner was not available Luther was the boss. He hired and fired people, placed advertisements, booked dates and wrote out checks, although only petitioner had signatory authority. Petitioner made the final decision on live acts and certain film purchases.

Luther did a great deal of film purchasing for petitioner. Every two to three months he would purchase 15-30 films at

a cost of approximately $500-$1,500 apiece. The payments were usually made 50 percent in cash and 50 percent by check.

Lou Hollander was a theater manager. He had other responsibilities too. Either Mr. Hollander or Ms. Miltenberg would collect the box office receipts every weekday morning. The receipts were brought back to the main office and entered on deposit slips.

Not all of petitioner's theaters operated at the same point in time. Often petitioner's theaters would stay open for a few months and then close.

There were several business reasons to maintain this type of corporate structure in the adult entertainment business. The obscenity laws take into account the mores of the local community. Petitioner's corporate structure prevented all of his theaters from being shut down if there was an isolated violation of an obscenity law. Furthermore, since petitioner's theaters opened and closed frequently, the multi-corporate structure prevented all of petitioner's operations from being liable for the expenses and lease liabilities of a theater which went out of business.

Each of the corporations maintained separate books and records. Each corporation also maintained separate checking accounts. Despite the appearance of independence, however, there were a multitude of intercorporate financial transactions as well as numerous financial transactions between the corporations and petitioner, their sole shareholder.

Appendix E

An idiosyncrasy of the adult entertainment business is that many of the transactions occur after business hours and many are conducted strictly in cash. Petitioner often paid movie distributors and entertainers with cash. There were three main reasons for this. First, both the entertainers and the distributors traveled and they needed cash to meet their expenses. Second, knowing the risky, and often temporary nature of the adult entertainment business, film distributors would not always be willing to accept a check which might be returned for insufficient funds. Third, the film distributors were reluctant to accept checks in order to avoid the creation of a paper trail which could possibly be used against them if charged with a violation of pornography laws.

The problems associated with using cash were amplified in petitioner's business. If one of petitioner's checks bounced, rather than deposit cash to cover the check, petitioner would most often pay the check outright in cash. This caused bookkeeping problems because many times the check was lost and there was no record of which bills were paid. This meant relying on memory to account for many business expenses.

Another common practice connected with the use of cash in the operation of petitioner's business was that petitioner would cash checks in order to pay expenses. Therefore, rather than making the check payable to the creditor, petitioner would make the check payable to himself, an employee or to cash. The check was then either cashed at a bank or by a petty cash fund of one of petitioner's corporations. Then petitioner paid the creditor in cash. Obviously, the use of this method for paying bills added to the disallowance of

numerous deductions for lack of substantiation, and to the general confusion in these cases.

The disarray of the corporate books also affected petitioner's personal finances. The reason for this is two-fold. First, petitioner maintained open loan accounts with all of the corporations. Second, petitioner was the sole shareholder of six subchapter S corporations and, as such, the corporations' taxable income or net operating losses flowed through to him as an individual. Sections 1373 and 1374.

Petitioner used the open loan accounts as a method both for infusing a corporation with capital and a method of withdrawing cash from his corporations. None of the loan transactions between petitioner and the corporations were evidenced by promissory notes or repayment schedules. Between 1974 and 1975 petitioner withdrew almost $130,000 in shareholder loans from his corporations and through 1978 he withdrew a total of over $2,000,000 from his corporations. During this same period petitioner declared only $35,000 in taxable income from the same corporations.[9] (See Appendix C) Petitioner also advanced several hundred thousand dollars in loans to the corporations.[10]

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9. Petitioner received a salary of $35,000 in 1974. He did not receive a salary in 1975 through 1978. During 1974 through 1978 petitioner did not net any subchapter S income because his reported losses and carryovers of net operating losses from loss corporations exceeded the gains earned in petitioner's profitable corporations.

10. The disarray of petitioner's books makes it impossible for the Court to determine exactly how much money was either loaned

(Cont'd)

Appendix E

Petitioner also borrowed money from other sources. At times he borrowed money from his long-time associates Oscar Markovich, William Berger or Joseph Savino. In total he probably borrowed several thousand dollars. Most of the time the money was borrowed either to go into another venture or to start another theater.

The interdependence between personal and business funds was even further entwined. In the early 1970's petitioner was involved in the production of a movie entitled "My Third Wife, George."[11] In connection with the movie, petitioner opened a bank account to cover expenses and to collect profits. "My Third Wife, George" was never part of any of petitioner's existing corporations, nor did it ever file any tax returns. The record is unclear as to whether any profits were ever made by the film. Thus, it is also unclear whether any profits were or should be included in petitioner's income.

The "My Third Wife, George" account became the personal checking account of petitioner. Between August 29,

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to petitioner or borrowed from petitioner at any particular point in time. Moreover, in many cases loans from one corporation to another corporation were filtered through petitioner's loan accounts. Thus, the circuitry of the transactions presents another obstacle in our determination of how much money was contributed or invested by petitioner.

11. Monique Productions produced the film "My Third Wife, George." The record is unclear as to petitioner's ownership interest in Monique Productions.

1975 and August 31, 1976 alone, $143,150 was deposited into this account and $142,800 was expended from it.

Petitioner had a reputation as a card player. He played cards with William Berger, Joe Savino and Hyman Lazar. He also had a reputation as a gambler. Petitioner traveled to the Bahamas and Las Vegas on several occasions. In fact petitioner paid as much as $42,500 to seven different casinos out of the "My Third Wife, George" account between August 29, 1975 and August 31, 1976. The checks paid off petitioner's outstanding lines of credit at the casinos.

During the years in question, petitioner was living at 4460 Bay Point Rd., Miami, Fla. This was a fairly affluent section of Miami. Petitioner, who was single, lived in the home with his girlfriend Linda Rivera and three of his children, Kimberly, Cash and Sean. Gayety, one of petitioner's S corporations, owned the home.

At the time petitioner was living at Bay Point Rd., petitioner's sister, Margaret Jenkins, and her five children were living rent free at 539 Euclid Ave., an apartment building owned by another of petitioner's corporations. Floyd and Shirley Griffith, petitioner's father and stepmother, were also living at 539 Euclid Ave.

Petitioner is the father of four children, Kimberly, Cash, Sean and Charles. He has been married at least once to Monique (Juanita) Lauderville, who worked for petitioner for a short time and is the mother of Kimberly. Joy Griffith Maci is the mother of two of petitioner's other children and Maryanne Tobin is the mother of petitioner's fourth child.

Appendix E

Maryanne Tobin also occasionally worked for petitioner in some capacity. Petitioner's father Floyd and his stepmother Shirley also worked for him. Floyd Griffith was a handyman at all of the local theaters and Shirley helped Floyd as well as filling in elsewhere as needed.

OPINION

Consents to Extend the Statutory Period for Assessment and Collection of Tax

Petitioner executed two powers of attorney on behalf of himself individually, in favor of Richard Reisenberg, his accountant, for the 1970 through 1976 taxable years on February 22, 1977; and on June 15, 1979 for the 1970 through 1977 taxable years. Petitioner utilized respondent's Form 2848 to grant these powers of attorney. The preprinted form provides five specific powers that are granted by signing the Form 2848. The taxpayer is advised to strike through any of the five powers which are not granted. One of the enumerated powers is the authority "to execute consents extending the statutory period for assessment or collection of taxes." Petitioner did not strike through any of the enumerated powers and thus granted Reisenberg an unlimited power of attorney. Reisenberg is neither a certified public accountant nor an enrolled agent before the Internal Revenue Service.

Side two of Form 2848 requires the signature of the person(s) receiving the power of attorney. If the person is an attorney, certified public accountant or an enrolled agent they must attest that they are not currently suspended or disbarred from practice and state their designation. A person who does

not fall into one of the three enumerated categories must have his or her signature witnessed and notarized.

Richard Reisenberg signed the first form under the designation of accountant on February 23, 1977. Two persons signed the witness portion of side two of the form on February 22, 1977, the date it was signed by petitioner. Reisenberg signed the second form under the designation of accountant on June 15, 1979 and two persons signed as witnesses on that date. Neither form was notarized.

This raises the question of the validity of the powers of attorney. Petitioner unquestionably granted Reisenberg a power of attorney on side one of Form 2848. Reisenberg unquestionably signed the form in acceptance of the power. Moreover, petitioner does not argue that the power of attorney is invalid because the Form 2848 was not properly witnessed or notarized. Therefore, we need not decide this issue. Petitioner's contention is that the consent to extend the statute of limitations, Form 872, was invalid for reasons hereinafter discussed.

There were a total of four consents to extend the statutory period (Forms 872) for the 1974 taxable year and three such consents for the 1975 taxable year.

The first consent to extend the statutory period for the 1974 taxable year was signed by Richard Reisenberg, under the power of attorney, on March 29, 1978. The form extended the time for assessment of tax for the 1974 taxable year until December 31, 1978.

Appendix E

The second consent for the 1974 taxable year and first consent for the 1975 taxable year were signed by Leroy Griffith on November 2, 1978 and extended the statutory periods to June 30, 1979.

Richard Reisenberg subsequently signed two additional consents for the 1974 and 1975 taxable years under a power of attorney. These consents, signed on June 5, 1979 and November 2, 1979, extended the period of assessment, first through December 31, 1979, and ultimately through December 31, 1980. The statutory notice was mailed to petitioner on September 19, 1980.

In his pleadings petitioner alleged that the statutory notice of deficiency as to 1974 and 1975 was invalid because it was barred by the statute of limitations. Respondent generally has three years to assess taxes. Sec. 6501(a). The statute of limitations can be suspended if the taxpayer agrees with the Secretary in writing, before the running of the statute, to extend the statutory period. Sec. 6501(c).

In this case petitioner claims that the statute of limitations bars the assessment and collection of tax for 1974 and 1975 because the consents extending the time period were invalid.

The party claiming the defense of a running of the statute of limitations has the burden of raising it in his pleadings. To meet his initial burden the party must present evidence that proves the notice of deficiency was issued more than three years after the taxpayer filed his return.

Appendix E

After the party successfully establishes this prima facie case, the opposing party must then go forward and present evidence that one of the four above enumerated exceptions exists. If the opposing party can do this the burden of going forward shifts back to the party claiming the defense to prove the alleged exception is invalid or inapplicable. *Adler v. Commissioner*, 85 T.C. 535, 540 (1985).

Here the petitioner presented a prima facie case that the notice of deficiency was untimely. Petitioner filed his 1974 tax return on June 13, 1975 and his 1975 tax return on April 27, 1976. The statutory notice of deficiency was issued on September 19, 1980, more than three years after the returns were filed.

Respondent has shown that consents were signed "Richard Reisenberg, Power of Attorney," extending the statutory period until December 31, 1980; and that the statutory notice of deficiency was mailed within the time of the last consent extending the period for the assessment and collection of tax. Petitioner argues that the consents are invalid "on their face" and therefore respondent retains the burden of proving the validity of the consents. We disagree. It is not apparent from the face of the consent,[12] as opposed

12. Face of instrument is defined as:

> – That which is shown by the language employed, without any explanation, modification, or addition from extrinsic facts or evidence. *Investors' Syndicate v. Willcuts*, D.C. Minn., 45 F.2d 900, 902. Thus, if the express terms of the paper disclose a fatal legal defect, it is said to be "void on its face." * * * [Black's Law Dictionary (1979).]

Since there is no evidence of a fatal legal defect on the "face of the instrument," the consent cannot be said to be invalid on its face.

to the Form 2848, that Reisenberg is authorized to extend the period for the assessment and collection of tax under respondent's regulations. Rather, this fact can only be discerned by reference to other documents in conjunction with the consent. Respondent has presented evidence, discussed below, that an exception to the statute of limitations exists and therefore, the burden of going forward shifts back to petitioner who must prove the consents extending the statutory period were invalid.

Petitioner argues that the consents signed by Richard Reisenberg are invalid because under respondent's own regulations a person who is not an attorney, certified public accountant or an enrolled agent is not authorized to sign a consent extending the period for assessment and collection of taxes, and that respondent's agent knew that petitioner's accountant was not a certified public accountant or an enrolled agent.[13] Furthermore, petitioner argues that respondent's agent misled petitioner and Reisenberg into signing the consents because he informed Reisenberg in writing that failure to sign would result in a notice of deficiency being issued and a loss of all of petitioner's appeal rights within the Internal Revenue Service. Finally, petitioner argues that Reisenberg lacked the actual authority to sign the consents to extend the period for assessment and collection of tax, because he did not seek and receive petitioner's permission before signing.

Respondent answers that the regulations issued by the Treasury Department are directory rather than mandatory,

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13. See discussion of Circular 230, 31 C.F.R., Part 10, 1966-1 C.B. 1171, and Rev. Proc. 68-20, 1968-1 C.B. 812, *infra*.

and so the fact that Reisenberg is not an attorney, certified public accountant or enrolled agent does not automatically invalidate the consents. Further, petitioner specifically granted Reisenberg the power to execute the consents at issue by giving him an unlimited power of attorney. Finally, even if Reisenberg did not have the actual authority to execute the consents, petitioner should be equitably estopped from claiming Reisenberg lacked authority.

We note parenthetically that both parties use the term "regulation" in referring to Circular 230, 31 C.F.R., Part 10, 1966-2 C.B. 1171, which, as noted, appears in the Code of Federal Regulations. For purposes of this discussion we adopt their terminology.

Circular 230, issued by the Treasury Department in 1966, sets forth the revised rules of practice before the Internal Revenue Service for the years in issue. Section 10.7 provides that persons who are not attorneys, certified public accountants or enrolled agents may practice before the Service in a limited manner. Section 10.7(a)(7), the applicable provision to this case, specifically provides:

> (7) Any person, who is not under disbarment or suspension from practice before the Internal Revenue Service or from practice of his profession by any other authority (in the case of attorneys, certified public accountants, and public accountants) and who signs a return as having prepared it for the taxpayer, or who prepared a return with respect to which the instructions or regulations do not require that it be signed by the

person who prepared the return for the taxpayer, may appear without enrollment as the taxpayer's representative, with or without the taxpayer, before revenue agents and examining officers of the Audit Division in the offices of District Directors (but not at the district conference in a District Director's office) with respect to the tax liability of the taxpayer for the taxable year or period covered by that return. Proper authorization from the taxpayer will be required. *All such persons will be subject to such rules regarding standards of conduct, the extent of their authority, and other matters as the Commissioner of Internal Revenue shall prescribe.* Such persons will be permitted to represent taxpayers within those limits without enrollment, except that the Commissioner may deny permission to engage in such limited practice to any person who has engaged in conduct which would justify suspension or disbarment of any attorney, certified public accountant, or enrolled agent under the provisions of this part. [1966-2 C.B. 1177-1178. Emphasis added.]

Pursuant to this provision, respondent issued Revenue Procedure 68-20, 1968-1 C.B. 812. Section four of the Procedure specifies the limitations on the practice privilege for those who are not enrolled to practice before the Service. Section four, Subpart .02(c), specifically states that *executing consents to extend the statutory period for assessment or collection of tax is beyond the scope of authority of an unenrolled preparer.*

Appendix E

Both petitioner and respondent focus their arguments on the *regulation* and what it "requires" respondent to do. But the *regulation* has not been violated by either party. The only limitation actually specified in the regulation is that unenrolled preparers may not appear at the district conference in a District Director's office. That did not occur in this case. The real question, instead, is "who violated the *revenue procedure* promulgated pursuant to Circular 230, and what consequences flow from that violation?"

Here, Reisenberg, an unenrolled preparer, signed a consent. Under the revenue ruling, this act was beyond the scope of his authority. Even though respondent erroneously accepted the consent, it is petitioner's accountant, armed with an unlimited power of attorney, who violated the revenue procedure. The revenue procedure does not require respondent to do anything. It requires the *taxpayer* to do something, i.e., to be represented by a person with certain credentials.

The fact that respondent's agent knew Reisenberg was not an enrolled agent does not change the result. The revenue procedure is directory, not mandatory. Respondent would have been justified in refusing to accept the consents signed by Reisenberg. The converse is not true. Petitioner cannot ignore the revenue procedure by allowing his accountant to sign the consents and then claim the consents are invalid because respondent accepted them. The bottom line is that respondent did not take any action contrary to either the regulation or the revenue procedure. Petitioner's duty of consistency mandates that he be bound by the consequences of his own actions. See, e.g., *Arkansas Best Corp. v.*

Commissioner, 83 T.C. 640, 659 (1984), affd. in part, revd. in part 800 F.2d 215 (8th Cir. 1986) affd. __ U.S. __ (March 7, 1988); *Southern Pacific Transportation Co. v. Commissioner*, 75 T.C. 497, 838-839 (1980). We find that the consents are valid.

This brings us to petitioner's next argument — namely that he and Reisenberg were misled into signing the waivers and as a result, they are invalid. In essence petitioner is claiming the waiver was signed either under mistake or duress. In either event, we do not agree that respondent's actions invalidate the waivers.

Agent Crane informed Reisenberg in two separate letters that failure to extend the statute of limitations would force Crane to issue a statutory notice of deficiency based upon the information from the audit, and that petitioner's appeal rights within the Revenue Service would be lost. This statement was only partially true. Typically, when a case is docketed in this Court and it has not yet been through the Appeals Office, respondent sends the case to Appeals for a taxpayer's conference before it is sent to district counsel. See sections 601.105 and 601.106, Statement of Procedural Rules. Although petitioner would not typically forfeit his rights to an Appeals Conference, after a petition is filed in this Court a case may not be settled administratively. The Court must agree with the settlement and enter the decision.

Moreover, to protect the statute of limitations respondent could lawfully issue a deficiency notice if petitioner refused to extend the statute. Threatening lawful action, even if contrary to stated policy, is not duress. *Burnet v. Chicago*

Ry. Equipment Co., 282 U.S. 295 (1931). There is nothing in either the Constitution or the Internal Revenue Code which requires appellate review within the Internal Revenue Service. The lack of appellate review, without at least a showing of harm from the denial of the appellate review, is not a violation of due process. See *Rosenberg v. Commissioner*, 450 F.2d 529, 533 (1971). (Taxpayer received a hearing de novo in the Tax Court and failed to show what would have been gained by a conference with the Appellate Division.) Thus respondent *could have* lawfully carried out precisely what Crane "threatened." Petitioner's claim of duress or mistake must fail.

Finally, we address petitioner's argument that Reisenberg lacked actual authority to sign the consents. Petitioner claims that Reisenberg signed the last two consents that extended the statutory period without petitioner's approval. The fact is, however, that petitioner executed an unlimited power of attorney in favor of Reisenberg in February 22, 1977. This gave Reisenberg actual authority to act on petitioner's behalf. See 1 Restatement, Agency 2d, sec. 26 (1958). That power of attorney was delivered to and accepted by respondent. This created an apparent authority in Reisenberg to act on petitioner's behalf. See 1 Restatement, Agency 2d, sec. 27 (1958). Whatever the actual arrangement between Reisenberg and petitioner, there was never any indication made to respondent that Reisenberg's authority to act on petitioner's behalf was limited.[14] The fact

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14. The 1 Restatement, Agency 2d, sec. 124A provides that the termination of authority does not thereby terminate apparent authority. In addition, as a general rule, the third party must receive

(Cont'd)

that petitioner now claims that he never intended to have Reisenberg sign the consents is not controlling. Petitioner is bound by and liable for the acts of his agent until such time as his apparent authority was effectively terminated. Thus, we cannot find the consents invalid for lack of authority since petitioner has not shown that Reisenberg's authority was effectively terminated. The consents are valid.

Substantive Issues

We now must address the substantive issues in this case. As a preliminary matter, respondent's determination in the notice of deficiency is presumed correct and petitioner has the burden of proving either his entitlement to any deductions or any erroneous inclusions in income. *Welch v. Helvering*, 290 U.S. 111 (1933); Rule 142(a). This is true in this case, even though the reasons for respondent's adjustments are not specified in any greater detail than is depicted in the chart at Appendix A. As a result of the lack of precision, we are able only to consider on redetermination those specific items raised by petitioner.[15] Any item or amount of the

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notice in order to effectively terminate an agent's apparent authority. See 1 Restatement, Agency 2d, secs. 125-132. Additionally, the Internal Revenue Service has issued rules on the revocation of power of attorney. The rules require the taxpayer to send a signed statement to those offices of the Internal Revenue Service where the taxpayer has filed copies of the power of attorney which is to be revoked listing the names and addresses of the representatives whose authority is revoked. Section 601.505(c)(2), Statement of Procedural Rules.

15. Petitioner could have used the Court's discovery rules to obtain a more definite basis for respondent's determination.

deficiency not addressed by petitioner is deemed to be conceded and found in respondent's favor.

(1) *Substantiation of Deductions*

(a) *Film Expenses*

The first substantive issue we address is petitioner's substantiation of film expenses. Petitioner has the burden of proving entitlement to those film expenses disallowed by respondent and those film expenses he now claims he failed to deduct or miscategorized as travel and entertainment expenses. Rule 142(a); *Welch v. Helvering*, *supra*. In 1974 petitioner claimed $159,149 in film expenses. Respondent allowed $127,299. During 1974 petitioner operated seven theaters for the entire taxable year and one theater for approximately six months. In 1975 petitioner claimed $197,014 in film expenses for the operation of ten theaters for the entire taxable year. Respondent allowed $64,114. In 1976 petitioner claimed $152,464 in film expenses for the operation of twelve theaters. Respondent allowed only $3,064. In 1977 petitioner claimed $39,364 in film expenses for the operation of six theaters. Respondent allowed $16,589. Finally, in 1978 petitioner claimed $24,553 in film expenses for the operation of five theaters, and respondent allowed $3,886.

The deductions respondent disallowed were payments in 1974 and 1975 to "My Third Wife, George"; payments in 1975, 1976 and 1977 to GTI[16] and payments to "cash" during all the years in question.

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16. Respondent maintains inconsistent positions regarding the film expenses paid by the corporations to GTI. In docket No. (Cont'd)

Petitioner contends that the payments to "My Third Wife, George" and to "cash" represent cash expenditures for films. Petitioner further asserts that his business purchased a large portion of its films for cash. Cash payments were used because of the Supreme Court's decision in *Miller v. California*, 413 U.S. 15 (1973), which defined pornography in terms of local community standards. This resulted in concern over creating a paper trail which could be used in either civil or criminal prosecutions.[17]

Petitioner further asserts that payments to GTI were legitimate film rental expenses. GTI was incorporated for the stated purpose of purchasing films and then renting them to petitioner's theaters.

In addition to the disallowed deductions, petitioner alleges he is entitled to deduct cash expenditures for films and other items which he previously miscategorized as travel and entertainment expenses. In support of the previously unclaimed expenses petitioner directs us to an exhibit containing several canceled checks. Petitioner argues that the checks written to round numbers such as $1,500 or $5,500

(Cont'd)
22089-80 respondent disallowed all the film expenses paid to GTI after it filed its final return on March 31, 1975, on the ground that GTI was defunct after that time. However, in docket No. 4032-85, respondent asserts that petitioner is liable as transferee of GTI and he includes all of the amounts paid as film expenses by the corporations in the gross income of GTI in 1975, 1976 and 1977.

17. See *Jolar Cinema, Inc. v. Commissioner*, T.C. Memo. 1983-403.

were really cash expenditures for films. All of these "missed deductions" were in 1977.

Petitioner also claims that in 1974 five of his corporations paid $21,000 to Sol Abrams as film expenses but that the deduction was erroneously shown on returns as travel and entertainment expenses.

Finally, petitioner suggests an alternative approach to deal with all the film deductions. Petitioner suggests that rather than look at particular items, we could look to 1974 and 1975 when respondent allowed petitioner to deduct an average film expense of $20,000 per theater. Using this as a guide we should allow $20,000 for each theater in operation during each of the five tax years in question. Petitioner contends that even though this results in his losing the benefit of cash expenditures made during 1974 and 1975 because he would not be entitled to any additional previously unclaimed film expenses, it provides a fair and easy way to estimate expenses.

We begin by examining whether petitioner is entitled to the deductions he actually claimed. First, petitioner has not convinced us that the "My Third Wife, George" account ever actually was used for film rentals to his corporations. Therefore, those deductions taken in 1974 and 1975 for payments to "My Third Wife, George" were properly disallowed. Second, payments to cash could have been for anything. The testimony at trial did not convince us that these particular checks were for film expenses. Therefore checks payable to cash were also properly disallowed.

Third, petitioner has failed to convince us that GTI continued in existence after March 31, 1975. Conspicuously missing from evidence are canceled checks from GTI to film vendors after March 31, 1975. There is no question that petitioner purchased hundreds of films. He has failed to convince us, however, that GTI purchased the films and that the films were then rented to the separate corporations. Respondent was correct in disallowing deductions for payments to GTI after March 31, 1975.

It is not our intention to totally disregard reality. From the evidence presented at trial we know the following facts: (1) petitioner showed films in his theaters; (2) petitioner, through his corporations, operated one theater for six months in 1974 and seven theaters for all of 1974, ten theaters during 1975, 12 theaters during 1976, six theaters during 1977 and five theaters during 1978; (3) films were shown at one theater and then transported to and shown at another of petitioner's theaters; (4) petitioner typically ran two shows in each theater; and (5) petitioner paid between $500 and $1,500 for each adult film. Several witnesses testified that petitioner's practice was to have two different films in each theater and to not repeat the same film at any one theater during the year. Using our best judgment, and bearing heavily against petitioner for his lack of records (*Cohan v. Commissioner*, 39 F.2d 540 (2d Cir. 1930)), we find petitioner purchased or rented 104 films per year. Finding each film to cost $500, petitioner, through his corporations, expended at least $52,000 per year on films ($500 x 104 films).[18]

18. We have considered how many theaters were in operation to determine the amount of allowable film deductions. The theaters were owned by petitioner's wholly owned S corporations. Therefore, the total $52,000 per year deduction for films is allocated between the corporate owners.

Appendix E

In summary, after taking account of the film expenses respondent has allowed, petitioner's corporations are not entitled to any additional film expense deductions for 1974 or 1975. Petitioner's corporations are entitled to additional deductions of $48,936, $35,411 and $48,114, respectively for the 1976, 1977 and 1978 taxable years. Moreover, using the amounts claimed on the corporate returns as a guide, the following percentages of the increased allowable deductions are allocated to various corporations:

	1976	1977	1978
Gayety	34.4	16.0	70.0
Griffco	15.6		
Paris Follies	36.4	10.5	20.0
L.C. Griffith	9.1	6.0	8.0
Ell Gee	4.6	3.5	2.0
Carib		64.0	

(b) *Finder's Fee*

On August 30, 1961, Ninth Street Amusement Company, Inc. (Ninth Street) entered into a lease with Stanley Company of America, Inc. (Stanley) as lessor. The lease was for a burlesque theater located in Washington, D.C. Oscar Markovich operated the concessions at the burlesque theater.

Petitioner was always interested in starting new theaters. On November 4, 1963 petitioner sent a letter to Ella Davis, Oscar Markovich's girlfriend. The letter referred to the assumption of the lease existing between Ninth Street and Stanley and provided:

Appendix E

This letter will confirm that you are arranging for the undersigned to assume the lease presently existing between Stanley Company of America, Inc., as lessee, and the 9th Street Amusement Company, Inc. as lessor. In view of your bringing this deal to my attention and indicating that the operation will be financially beneficial, and further considering your assignment to be entered into, I feel that you are entitled to a finder's fee.

Therefore, if the assignment is entered into and I assume the above lease, and if I operate under the said lease for the full term and duration, and if the said operation is financially successful as you indicated, I will pay to you at the expiration of the said lease the sum of $50,000.00 as a finders fee.

Between 1968 and 1971 several payments were made to Ella Davis. On June 12, 1972 Leroy Griffith executed a mortgage deed on Gayety Theater to Davis securing a $50,000 promissory note, without interest, whereby Davis was to be paid $200 per week until paid in full. Payments began in July 1972. During the years which are before the Court, petitioner, through Gayety, paid Davis $10,400 in 1974, 1975 and 1976, and an additional $4,200 in 1977. In 1978 Davis was paid $5,200 recorded via an adjusting journal entry on Gayety's books.

Petitioner argues that he had a personal obligation to pay Davis $50,000 for the assignment of the lease and that Gayety only entered the transaction to provide security.

Petitioner also argues that he is entitled to the ordinary deduction for the finder's fee payment because he was engaged in the business of operating theaters and that the payments were related to his business. Finally, petitioner asserts the payments were deductible whether claimed on Gayety's corporate tax return or petitioner's individual tax return.

Respondent argues that the payments to Davis are not deductible. Respondent relies on two arguments in making this determination. First, petitioner has failed to prove the $50,000 payment was an ordinary and necessary business expense within the meaning of section 162. Second, the transaction was a sham. The agreement between petitioner and Davis provided that part of her consideration for the $50,000 was an "assignment to be entered into." There is no evidence in the record indicating to what this statement refers. Respondent argues that since petitioner presented no evidence of the "assignment" he has not shown that Davis fulfilled her obligation and he has not met his burden of proof as to the deductibility of the payments. Further, respondent asserts the agreement was a sham because although petitioner purports to paying a "finder's fee" to Davis, he fails to mention that he was president of Ninth Street at the time of the assignment. Thus, it is apparent petitioner both knew of the lease and *owned* the lease before the assignment for which Davis was paid.

The evidence supports respondent's claim. The facts clearly indicate that Ella Davis was not paid a fee for "finding" the theater in Washington, D.C. Petitioner has not presented any additional evidence which would justify

payments of $50,000 to Davis either as his own business expense or as a business expense of Gayety. Therefore, petitioner is not entitled to a deduction under section 162.

(c) *Auto Expenses*

Petitioner used two automobiles in his businesses. He traveled between the theaters on a regular basis to monitor their operations. Certain of petitioner's employees also used petitioner's automobiles to pick up entertainers at the airport and to drop films off at other theaters and the bus terminal. Petitioner and Linda Rivera also used the two automobiles for their personal needs.

Between 1974 and 1977 L. C. Griffith, Ell Gee and Gayety all claimed deductions for auto expenses. Respondent conceded a depreciation deduction in the amount of $2,292 for Gayety in 1974 through 1976, inclusive. Gayety did not claim any additional auto expenses. Petitioner claims that Ell Gee and L. C. Griffith are entitled to the following additional deductions as reported on the corporate returns which respondent disallowed.

	1974	1975	1976	1977
Ell Gee				
auto & truck expenses	$640	$1,629	$1,320	$670
depreciation	1,801		2,202	
insurance	592.50		1,290	833
L. C. Griffith				
repairs			114	

Appendix E

In addition, since petitioner's corporations failed to claim depreciation and actual expenses on two cars for all the years before the Court, petitioner claims the corporations are entitled to previously unclaimed deductions.[19]

Petitioner presented no evidence at trial concerning either petitioner's, nor any of the corporation's, bases in the two automobiles. He also failed to present any evidence concerning when the vehicles were put in service and when they were taken out of service. Respondent has conceded that Gayety is entitled to depreciation on one vehicle in 1974, 1975 and 1976. There is no evidence which indicates Gayety is entitled to depreciation in 1977 or 1978. Similarly, since petitioner failed to prove Ell Gee had any basis in the second automobile and failed to prove when it was in service, we have no reason to allow Ell Gee to depreciate an automobile.

Petitioner also contends Ell Gee is entitled to the auto expenses it claimed on its return. These include general expenses and insurance. Petitioner failed to present any evidence such as canceled checks, the policy itself, or testimony of an insurance company employee to substantiate insurance expenses. Petitioner's failure to produce this evidence leads us to conclude that this type of evidence would not have supported petitioner's claim. *Wichita Terminal Elevator Co. v. Commissioner*, 6 T.C. 1158, 1165, (1946), affd. 162 F.2d 513 (10th Cir. 1947).

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19. Petitioner's argument on these previously unclaimed auto expenses is very vague and general. We are unsure of exactly what amount of previously unclaimed deductions he is presently claiming.

Likewise, petitioner failed to present any evidence to substantiate the general automobile expenses. He failed to maintain any type of mileage log which would have entitled him to use the optional method for computing automobile expenses. Therefore, Ell Gee is not entitled to either the general auto expenses or the insurance expense.[20]

Petitioner did not submit any evidence substantiating the $114 repair expense taken by L. C. Griffith. We do not know to which vehicle the alleged repair was made or that the repair was an ordinary and necessary business expense. Therefore, we cannot allow L. C. Griffith's repair deduction.

(d) *Contract/Casual Labor*

After concessions by respondent the following deductions remain in dispute:

	1974	1976	1977
Griffco	$ 50	$ 650	
Ell Gee	100	2,500	$800
Carib			100

All of these deductions were for payments made to Floyd and Shirley Griffith. There was a great deal of testimony at trial substantiating contributions made both by Floyd and

20. Under *Cohan v. Commissioner*, 39 F.2d 540 (1930), we are empowered to make an allowance for local transportation based on an estimate if we are convinced the expense was actually incurred and a basis exists to estimate the deduction. In this case petitioner has failed to provide us with such a basis.

Shirley Griffith to petitioner's operation. In fact, respondent has conceded the portion of the claimed contract/casual labor payments made to Floyd and Shirley Griffith attributable to Gayety.

The evidence presented at trial convinced us that Floyd and Shirley Griffith provided services to many of petitioner's theaters located in the Miami area. The above three corporations all operated theaters in and around Miami and we believe that Floyd and Shirley Griffith provided services to these theaters too. These corporations are entitled to the above-mentioned additional labor expenses under section 162.

(e) *Miscellaneous Itemized Deductions*

There are two miscellaneous itemized deductions at issue. Petitioner claims he is entitled to an $8,500 deduction in 1974 and a $2,700 deduction in 1977.

In 1974 petitioner attempted to get a loan of $640,000. In connection with this loan, which he never received, he claims he paid the person who brought the deal to his attention $8,500. Of this amount, $3,500 was in the form of a cashier's check and $5,000 was in cash. Petitioner never got his money back even though the loan was not made.

In support of this deduction petitioner introduced the customer copy of the $3,500 cashier's check. He also submitted an unsigned agreement that calls for a nonrefundable $3,500 application fee which is applied towards costs if the loan is approved. Petitioner failed to

produce any evidence of a business purpose for the loan. Absent such a showing, even if petitioner actually paid the money, he is not entitled to this deduction under section 162.

Petitioner claims the $2,700 payment in 1977 was to Manuel Uriate and was the cost to produce "Cabaret" with a female impersonator at the Roxy Theater and the Carib Theater. To substantiate his entitlement to this deduction petitioner submitted an unsigned, uncashed check payable to Manuel Uriate drawn on the "My Third Wife, George" bank account. The notation on the check reads "For Cabaret Cast Roxy 3/29-4/3." Also, across the check it reads "paid by cash." This evidence combined with petitioner's testimony convinces us that $2,700 was paid for this production. Under normal circumstances this evidence would be insufficient, but several witnesses at trial corroborated petitioner's practice of writing unsigned checks to use as receipts for cash payment. Therefore, petitioner is entitled to a $2,700 miscellaneous deduction in 1977.

(2) *Previously Unclaimed Deductions*

According to petitioner there are five general categories of previously unclaimed deductions still at issue (in addition to the previously unclaimed auto expenses discussed above). These categories are set out separately below.

(a) *Additional Rent Deductions for Paris Follies' Pussycat Theater (New Orleans) for 1976, 1977 and 1978*

Paris Follies operated the Pussycat Theater in New Orleans, La. during 1976, 1977 and 1978. Petitioner claims

Appendix E

Paris Follies is entitled to accrue $75,000 for rent expenses on the Pussycat Theater for 1976 and 1977; and $73,350 for 1978. On its corporate return Paris Follies deducted the following amounts, which respondent allowed in full:

1976	$51,499
1977	25,802
1978	71,550

Thus, the amounts in issue are $23,501 for 1976, $49,198 for 1977 and $1,800 for 1978.

In support of his assertion petitioner submitted an unsigned copy of a lease agreement between Trans-Lux, a New Orleans corporation as lessor and BGNO (which stood for Berger Griffith New Orleans), a New Orleans corporation, as lessee. According to petitioner Paris Follies assumed the lease which existed between Trans-Lux and BGNO; the lease required $75,000 in annual rent in 1976 and 1977; and the rent was reduced in 1978 from $75,000 to $54,600 in consideration of forfeiture of the $18,750 security deposit Paris Follies paid on the lease.

The document which petitioner submitted is an unsigned copy of a lease. We do not consider this document to be evidence of a final agreement between Trans-Lux and BGNO, the apparent original parties to the lease. Even if we did accept the lease as the final agreement between the parties, under the terms of the lease the lessee must get written consent to assign the lease. Thus while petitioner claims Paris Follies assumed the lease, he has failed to introduce the documentary evidence to support his position.

Appendix E

The lease in evidence extends for six months from May 16, 1975 to November 15, 1975. According to the terms of the document the lessee was required to give written notice of its intent to renew the lease. Petitioner has not submitted any evidence which indicates that Paris Follies or BGNO renewed the lease.

In sum, we have not received any evidence which proves Trans-Lux actually entered into a lease agreement with BGNO or that Paris Follies assumed the lease liabilities of $75,000 annual rent of BGNO.

The parties have stipulated that Paris Follies operated the pussycat Theater in New Orleans. We do not doubt that fact. We do, however, doubt that Paris Follies was legally liable for $75,000 rent in 1976 and 1977 or $73,350 rent in 1978. Therefore, we see no reason to allow Paris Follies to deduct rent expenses beyond those it originally claimed and which respondent originally allowed.

(b) *Additional Deduction for Payments Made With Regard to the Liberty Bank and Trust Company Account*

Petitioner and Donald James, one of petitioner's employees, had a bank account at Liberty Bank and Trust Co. in New Orleans, La. Petitioner claims he is now entitled to the following deductions in 1977 for payments made from the Liberty Bank account to pay expenses for the Pussycat Theater in New Orleans:

Appendix E

Film Rental	$ 500.00
Rent	5,000.00
Travel and Entertainment	650.00
Legal	1,220.00
Taxes	305.00
Utilities	547.85

In addition petitioner claims he is entitled to the following additional deductions for payments ultimately paid in cash, but which were represented by uncashed checks from the same account:

Film Rental	$ 400.00
Salary	1,681.83
Petty Cash	44.41

Petitioner has the burden of proving his entitlement to these deductions. Rule 142(a). He has failed to do this. Petitioner has simply placed copies of the checks into evidence. He has not shown a business purpose for the payments, nor has he shown that the items, if deductible, were not previously deducted in 1977 by Paris Follies, the corporation which operated the theater. Petitioner's testimony without more, does not convince us that he is entitled to deduct any of these additional amounts.

(c) *Additional Deductions for Legal Fees.*

In 1976 petitioner paid $9,000 in legal fees to Mr. Silvers, an attorney in New Orleans. Respondent has conceded that $4,000 of this amount is deductible. Respondent has also conceded that the total amounts claimed

for 1975 and 1977 are deductible. Petitioner lived in Florida and it is likely that any personal matters requiring legal advice would arise in Florida. We find the payments to Mr. Silvers in New Orleans were business related. Moreover, we see no reason why respondent would have conceded the other amounts but not this $5,000. Respondent has not suggested any reason why this $5,000 was not treated like the other amounts paid to Silvers. Therefore, petitioner is entitled to a $5,000 deduction for legal fees in addition to the amounts conceded by respondent.

(d) *Additional Checks Disbursed From Intercontinental Bank*

Petitioner claims he is entitled to the following previously unclaimed deductions in 1977 for expenses paid out of checking account no. 0101-405-502 at the Intercontinental Bank of Miami Beach:

Advertising	$21,651.33
Taxes	4,489.45
Legal and Accounting	2,462.54
Utilities	1,124.49
Salary	500.00
Film Purchases	1,500.00
Repairs & Maintenance	200.00

Mr. Silverman, an accountant hired to assist in the trial of this case, testified that the Intercontinental account was for Griffco. Griffco went out of business in 1976. Therefore, amounts paid from the account were not deducted in 1977 by Griffco. At trial petitioner submitted copies of the checks

at issue. There is no indication on the face of the checks that they were issued from a Griffco account. Other checks in evidence drawn in 1978 from the same account have "Griffco, Inc." imprinted on the face of those checks. We find, however, that the 1977 checks were in fact written from the Griffco account, and, since no returns were filed for Griffco after 1976, none of the allowable deductions were previously taken. Petitioner used funds left in the Griffco account to pay expenses of other theaters. The types of expenses incurred are business expenses. We thus find petitioner has substantiated the following additional deductions in 1977:

Advertising

Miami Herald	20,997.57
All Night Show	150.00
Showcase	405.00
The Weekly	100.00
Total	$21,651.57

Taxes

Internal Revenue Service	953.24
Fla. Dept. of Revenue	2,277.48
La. Dept. of Revenue	581.15
Total	$3,811.87

Legal and Accounting

Mincberg, Atty.	1,400.00
Reisenberg, Accountant	312.54
Total	$1,712.54

Appendix E

Petitioner has failed to prove his entitlement to any additional deductions. Checks he claims were for taxes were made out to the City of New Orleans. There is not a clear enough indication, even combined with petitioner's testimony, that those checks were in fact for taxes. We are also unconvinced that a $350 payment to Alan Pinkwasser, an attorney in the Miami area, and legal fees paid to Louis Merhige were business related. Petitioner provided us with no proof as to the business purpose of the payments. We are similarly unable to allow the additional $200 paid in 1977 to the attorney Mike Silvers because we do not know that the amount has not already been included in the sum conceded by respondent.

Petitioner also claimed utility expenses. We have no way of knowing, based on the evidence before us, exactly which of petitioner's utility bills were paid out of this account. Absent a clear showing that these were valid business expenses we cannot allow the deduction. Similarly, we cannot allow a deduction for claimed maintenance and repair expenses and a salary expense without a showing that these were incurred in the course of business.

Finally, in 1977 petitioner claimed an additional film expense of $1,500. We have already discussed our treatment of petitioner's film purchases. Since petitioner's allowed deductions are based on an estimate, we will not allow any additional specific items which were previously unclaimed.

(3) *Travel and Entertainment*

There are two categories of travel and entertainment expenses to consider in this case. The first category are those

disallowed travel and entertainment expenses. The second category of travel and entertainment are those which respondent disallowed and petitioner claims he miscategorized but were nevertheless deductible expenses.

Petitioner claimed the following travel and entertainment expenses between 1974 and 1978:

Entity	1974	1975	1976	1977	1978
Paris Follies	3,306	3,305	2,025	3,689	641
Griffco	6,720	7,884	3,212	—	—
Ell Gee	13,953	7,861	6,920	7,487	—
Gayety	17,846	16,442	12,722	3,819	6,318

The bulk of petitioner's proof of his entitlement to these travel and entertainment expenses is testimony at trial that petitioner did a large amount of traveling in his business. The fact that petitioner operates theaters in many states helps to substantiate this claim. Petitioner also took a trip to Europe in 1977 with Linda Rivera, Bud Luther and Luther's wife. Petitioner claims that all four of them were in Europe primarily for business reasons and therefore the costs are deductible.

There is, however, a problem with petitioner's evidence. He has failed to produce any evidence which shows exactly which travel and entertainment expenses were for business purposes. He kept no kind of contemporaneous log indicating the time, place, amount or business purpose of any expenses. A portion of petitioner's claimed travel and entertainment expenses were obviously for travel (i.e., checks payable to a

travel agency) or entertainment (i.e., checks payable to restaurants). However, without any evidence of the business purpose of the trip or meal, we cannot permit any deduction.

Travel and entertainment are subject to the restrictions on all business expenses. See sec. 162. Additionally, travel and entertainment expenses must satisfy the substantiation requirements of section 274(d). In order to meet the requirements of section 274(d) petitioner must not only show a business purpose for the expenditure, he must also prove the amount, time and place of travel or entertainment and, for the entertainment expenses, the business relationship to the taxpayer of every person entertained. Sec. 274(d); sec. 1.274-5(b), Income Tax Regs. Thus even though we believe petitioner did travel between his businesses, and that he entertained many of the live performers he hired, section 274(d) precludes us from estimating what expenses he may have incurred.

Furthermore, the European trip, which petitioner specifically addressed, is not a deductible travel expense. Section 1.162-2, Income Tax Regs., provides in pertinent part:

> Only such travel expenses as are reasonable and necessary in the conduct of the taxpayer's business and directly attributable to it may be deducted. If the trip is undertaken for other than business purposes, the travel fares and expenses incident to travel are personal expenses and the meals and lodging are living expenses * * *.

We believe that petitioner got ideas for his business while in Europe, but we remain unconvinced that business was the primary reason he went to Europe. Therefore, he is not allowed to deduct the cost of the trip. Furthermore, even if the trip to Europe was directly related to petitioner's business, petitioner has failed to produce any evidence to substantiate the deduction as required by section 274(d).

Petitioner also contends that several of his travel and entertainment expenses were miscategorized, and that a substantial amount of travel and entertainment expenses were really film expenses. We are not convinced that any greater deduction than we have allowed above for film expenses is warranted.

The other amounts petitioner claims were miscategorized as travel and entertainment expenses were payments made to the following people or entities:

Lana Lake, stripper
Mary Brown, employee
Melody Euchman, employee
Bingis Associates, sign company
Alan Weinstein, attorney
Petty Cash
BAC, Inc. (Georgeanna Spellman)
Night Owl Show

The only evidence presented at trial substantiating the deductibility of these expenses was petitioner's self-serving testimony. He has failed to convince us that these payments were ordinary and necessary business expenses. There is,

however, one exception in all of the above-mentioned expenses — the payment to Bingis Associates, a sign company. We find this expense to be business related. Therefore, Gayety is entitled to a deduction of $125 in 1975.

Additional Income

We now must decide whether petitioner received the following amounts of previously unreported income in the following years:

Source	1974	1975	1976	1977
Paramount Theater (return of security deposit)				$24,930
Bee Gee, Inc.	$4,400	$21,700		
Cameo Productions		2,097	3,100	
Flamingo Theater			3,262	
GTI (dividends)	8,254	38,947		

(1) *Paramount Theater*

Griffco was incorporated on September 1, 1972 and operated on a calendar year basis. Griffco is the corporation which operated the Paramount Theater. In 1977 petitioner received $24,950 as the return of a security deposit on the Paramount Theater. We must decide if this amount constitutes income to Griffco and therefore to petitioner as its sole shareholder.

Generally, a recovery of a prior payment does not result in income unless there was a tax benefit in a prior year.

Sec. 111; *Hillsboro National Bank v. Commissioner*, 457 U.S. 1103 (1982). The question, therefore, is whether petitioner or Griffco received a tax benefit in a prior taxable year.

Respondent claims that petitioner did enjoy a prior tax benefit. He claims petitioner deducted the security deposit from taxable income in 1972. Respondent's determination is based on two facts: (1) Petitioner did not include the security deposit as an asset in 1972 even though he did include the security deposit of $335 held by Southern Bell as an asset; and (2) Petitioner deducted $33,612.80 in rent for 1972 while his annual rental expense for 1973 and 1974 was $50,918 and $51,917, respectively. Since the corporation did not exist until September 1972, at most the 1972 rental payment covered a four-month period.

Petitioner argues that the security deposit is not a deductible item and since there is no evidence that the security deposit was deducted, petitioner did not realize any prior tax benefit. Moreover, petitioner argues that he was audited in 1972 and that if he had previously deducted the security deposit it would have been disallowed on audit.

There is no direct proof that petitioner previously deducted the security deposit. Respondent would like us to conclude that a substantial rental payment in 1972 for at most four months of operation indicates that petitioner previously deducted the security deposit. Based upon the 1973 and 1974 annual rental deductions petitioner should have incurred a rental expense of approximately $17,000 over a four-month period in 1972. If we accept respondent's argument, i.e., that $24,950 of the $33,612.80 deducted as rent in 1972 was in

fact a security deposit, it would mean that petitioner only paid approximately $9,000 in rent in 1972. If we accept petitioner's argument it would mean petitioner paid over $33,000 in rent in 1972. Neither party has done much to convince us that they are correct. We do note, however, that petitioner did not introduce any evidence as to the terms of the lease which would have done much to support his case. In light of petitioner's failure to present this evidence, we assume it would not have supported his position. *Wichita Terminal Elevator Co. v. Commissioner, supra.* Petitioner has failed to prove that he did not receive a prior tax benefit in 1972 by deducting the security deposit. As a result petitioner must include the return of that deposit in his 1977 income.

(2) *Bee Gee, Inc.; Cameo Productions, Inc. and Flamingo Theater*

Respondent determined that petitioner had additional income from Bee Gee, Inc., Cameo Productions, Inc. and the Flamingo Theater. His determination is based on the disallowance of claimed film expenses. The payments which respondent has included in petitioner's income were payments made by these entities, directly to petitioner or to GTI after March 31, 1975 (the date respondent determined GTI went out of business). Petitioner claims the payments made to him from these entities were for reimbursement of film expenses. Petitioner also contends that the amounts paid to GTI were properly included in GTI's income and did not constitute dividends to him.

Regarding the direct payments to petitioner, he points out that during the periods in question he did not wholly own any of the above-named theaters and that it is therefore

illogical to assume that the payments to him were anything other than reimbursement for film expenses. He claims the other co-owners would not have allowed him to take out these amounts as dividends without being charged with them.

There are flaws in petitioner's logic. First, none of the other co-owners' tax returns are currently before the Court so there is no way for us to determine whether the other co-owners received similar payments from the entities in question.

Second, noting petitioner's extensive experience in operating adult and family theaters, it is not inconceivable that the payments to petitioner could have represented some kind of payment for services. If this were the case, the other co-owners are not likely to have objected to the payments made to petitioner.

Although petitioner could have been reimbursed for film expenses by these entities, he has not convinced us that these particular payments were for reimbursements of film expenses. Testimony from his co-owners as to the nature of the payments might have constituted sufficient proof. In light of petitioner's failure to produce this evidence we assume the evidence would not have supported his position. *Wichita Terminal Elevator Co. v. Commissioner, supra.*

Moreover, since petitioner has earned additional income from these theaters, he is subject to self-employment tax on the income.[21]

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21. Petitioner also failed to address the self-employment issue. He did address the substantive income issue which we decide against him. We take his failure to raise the self-employment issue in the alternative to be a concession of the self-employment tax.

Petitioner also must include in his income the amounts respondent disallowed for payments made by these entities to GTI. Since petitioner has failed to convince us that GTI was in existence after March 31, 1975, all deductions taken for payments to GTI after that date are disallowed. Since the payments went to GTI, petitioner's wholly owned corporation, which we have determined was not in existence, the amounts paid to GTI after March 31, 1975 must be included in petitioner's income. *Moline Properties v. Commissioner*, 319 U.S. 436 (1943).

(3) *Dividend Income from GTI in 1974 and 1975*

GTI was in existence for 12 months in 1974 and three months in 1975. Between April 1, 1974 and December 31, 1974 petitioner withdrew $53,061.94 in shareholder loans from the corporation. Between January 1, 1975 and March 31, 1975, petitioner withdrew $43,094.84 in shareholder loans, but made loans to GTI totaling $65,497.88.

Based upon these transactions, respondent determined that the shareholder loans in excess of the contributions made by petitioner amounted to dividend income. Respondent also determined an additional $12,373.68 and $61,349.75 of payments deducted by GTI in 1974 and 1975, respectively, were for petitioner's benefit and therefore constituted dividend income to him. According to respondent, the net result is that petitioner had $56,682 in dividend income in 1974 and long term capital gain income of $8,254 and $38,946.71, in 1974 and 1975, respectively.

Petitioner contends that the withdrawals constituted bona fide shareholder loans. He further asserts that it was his

practice to borrow money from one corporation to pay bills of another corporation. Sometimes these loans were recorded directly to the other corporation. Other times the loan was recorded to his loan account and then he gave the money to the cash poor corporation.

Petitioner also contends that the amounts respondent claims were expended by GTI on his behalf did not provide him with any benefit. As a result, petitioner claims he should not include those sums in his individual income. Specifically, petitioner addresses payments made by GTI to Joseph and Betty Savino. Between January 10, 1975 and February 18, 1976 GTI paid the Savinos $57,500 in a series of post-dated checks. The checks represented repayment of a $50,000 loan at 15 percent interest between the Savinos (as lenders) and petitioner, Gayety and GTI (as borrowers).

Petitioner has failed to establish a business purpose for the $50,000 loan. Therefore, the payments are not deductible by GTI, Gayety or petitioner. Sec. 162. Furthermore since there was no business purpose established, we assume the loan from the Savinos provided personal benefits to petitioner who both signed the loan agreement and was the sole shareholder of GTI. We find that the payment of this loan was for petitioner's benefit and that the amount respondent determined was taxable income must be included as dividend income by petitioner.[22]

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22. We note that although the loan payments themselves are not deductible, $7,500, which constituted the interest over the term of the loan, is deductible if it was not previously claimed.

Appendix E

Petitioner has not presented any evidence as to the other payments made by GTI which respondent disallowed. Therefore, we reach the same result for those payments. That is, petitioner must include the payments as dividend income in 1974 and 1975.

We cannot agree with respondent's determination, however, that the shareholder loans constituted dividend income to petitioner. We are not convinced the amounts claimed as shareholder loans were anything but what they were purported to be. The fact that petitioner had an outstanding balance at the end of 1974 does not change our mind, nor does the fact that there were no documents evidencing the loans. The facts support petitioner's claim that he withdrew money from one corporation and deposited it into another. More importantly though, the facts indicate that substantial portions of the loans were paid back in early 1975. Thus, the amount borrowed in 1974 was not income to petitioner.

In 1975, however, we have found that GTI ceased doing business. In March of 1975 petitioner had an outstanding balance in his open loan account. Not receiving any evidence to the contrary, it appears the amount of debt outstanding was forgiven. Petitioner never mentioned making additional payments after that date. Therefore, we conclude that petitioner had additional income in 1975 equal to the amount of the balance in his open loan account with GTI on March 31, 1975. In sum, petitioner had dividend income in 1974 of $12,373.68, and in 1975 petitioner had dividend income of $61,349.75 and income from the forgiveness of indebtedness equal to $30,658.90 [($43,094.84 (shareholder loans in 1974)

Appendix E

+ $53,061.94 (shareholder loans in 1975)) – $65,497.88 (amount of shareholder loans repaid in 1975)].

4460 Bay Point Road

Petitioner lived at 4460 Bay Point Road with his girlfriend, Linda Rivera, and three of his children — Charles, Kim and Cash — during all the years in question. The house at 4460 Bay Point Road was owned by Gayety. Petitioner was Gayety's sole shareholder.

Gayety purchased the home in September, 1973. The cost basis of the building was $67,000, plus improvements of $34,769.74. The tax assessed value of the house in 1974 was $61,551 ($20,840 land and $40,711 building) and in 1975 was $86,994 ($27,780 land and $59,214 building). Gayety depreciated the house located at 4460 Bay Point Road during all the years in question. The depreciation was taken at four percent on the straight line method. Gayety's depreciation deduction was based on the following figures:

House	Date acquired	Cost or other basis	Depreciation for tax year
Building	12-73	$67,000	$2,680
Improvements	12-73	34,770	1,391
Land	12-73	18,000	-0-
Improvements	1-74	49,646	1,986
		Total	$6,057

There was no evidence presented at trial to support the claimed improvements of $49,646 in 1974. However, petitioner chose to capitalize the following expenses in 1974:

Appendix E

bar sink repair	$200.00
upholster 2 chairs	43.53
drapery work	266.00
awning	350.00
plumbing repair	127.00
fixtures and materials	950.00
repair of receiver & transmittor	88.00
Total	$2,024.53

In addition to depreciation, Gayety took annual deductions for interest, taxes, maintenance and repairs on the property. Between 1974 and 1978 Gayety deducted the following expenses:

	1974	1975	1976	1977	1978
Taxes*	$3,099.33				
Interest*	4,027.48				
House Maintenance	909.00				312.00
Telephone	104.18			327.00	60.40
Gas Service	167.00			163.71	238.23

* The stipulation specifies that petitioner deducted taxes and interest on the property in 1974. It is unclear from the record and Gayety's tax returns whether taxes and interest on the residence were deducted in 1975 through 1978. The stipulation also specifies gas and electric were disallowed to the extent of $1,737 in 1977. According to the information contained in the stipulation, however, the gas and electric bills totalled only $1,731.87. Therefore, the deduction cannot be disallowed for an amount greater than $1,731.87.

Appendix E

Repairs Including (plumbing, fixtures, exterminating, closed circuit television, air conditioning)	1,536.00	257.14			
Pool and Garden	909.00	1,367.00	967.00	781.00	495.00
HOA					480.00
Electric				1,568.16	481.81
Supplies		701.27			

In 1974 and 1975 petitioner "paid" $6,000 in rent to live at the Bay Point Road house. The payment was made through an adjusting journal entry to his loan account with Gayety. In 1976 petitioner "paid" $4,800 in rent. Again, the payment was by an adjusting journal entry on his loan account with Gayety. In 1977 and 1978 petitioner paid no rent.

There was no written lease between Gayety and petitioner. Petitioner did not maintain a log or other contemporaneous record of entertaining or other business use of the home.

The plan of having the corporation own the residence and allowing petitioner to rent it out was reviewed by one of respondent's revenue agents during a prior audit. Though not given extensive review, the agent indicated that if petitioner paid fair market value in rent, the arrangement

would not likely be a problem. At the time of this prior audit it was indicated that fair rental value was approximately $7,200 per year.

With the exception of $178 of the 1978 dues to the Homeowner's Association, respondent disallowed all of Gayety's claimed deductions for 4460 Bay Point Road based upon Code sections 162, 262, 274(a) and, from 1976 through 1978, section 280A.

Section 162 permits taxpayers to deduct all "ordinary and necessary" business expenses. Section 167(a)(1) provides a depreciation deduction with respect to "property used in the trade or business." Section 262 specifically disallows deductions for personal, family and living expenses. Section 274 disallows deductions for otherwise allowable expenses unless the taxpayer can fall within its narrow scope and meet its substantiation requirements. Under 274(a) a taxpayer is not allowed to deduct the cost of any activity considered to be entertainment, recreation or amusement or of any facility used in connection with that type of activity, unless he can establish that the activity was related to a bona fide business discussion or to the active conduct of his trade or business. Section 280A disallows certain expenses connected with the business use of a home. Generally, an individual or an S corporation is not allowed to deduct any of the costs associated with the use of a dwelling unit which is used as a residence by the taxpayer or the corporate shareholders during the taxable year. There are limited exceptions to this rule which do not apply here.

The initial question to be considered is whether the ownership and maintenance of the realty related primarily

to personal or to business purposes. In general, when the acquisition and maintenance of property such as a residence is primarily associated with profit-motivated purposes, and personal use can be said to be distinctly secondary and incidental, a deduction for maintenance expenses and depreciation will be permitted. *International Artists, Ltd. v. Commissioner*, 55 T.C. 94, 104 (1970). Conversely, if the acquisition and maintenance is primarily motivated by personal considerations, the deductions must be disallowed. Such expenditures are not ordinary and necessary and therefore fail to qualify as a deduction under section 162. *International Artists, Ltd. v. Commissioner*, *supra*. Moreover, the disallowance of personal expenditures is expressly mandated by section 262.

The above principles apply to corporate, as well as individual, taxpayers. In the former case, since the corporation cannot itself make personal use of the property, the character of an expenditure is determined by reference to the benefit conferred upon shareholders, officers, or other individuals in control of corporate affairs. *International Trading Co. v. Commissioner*, 275 F.2d 578 (7th Cir. 1960), affg. a Memorandum Opinion of this Court; *International Artists, Ltd. v. Commissioner*, *supra*. As in the case of individual taxpayers, the personal use by a shareholder of corporate property renders expenditures thereto personal and results in taxable income to the shareholder. However, where substantial business and personal motives exist, allocation becomes necessary.[23] *International Artists, Ltd.*, *supra* at 105.

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23. Sec. 280A, which is applicable for the 1976 through 1978 tax years, would preclude us from making an allocation between business and personal use without a showing of exclusive business use for a portion of the home for those years.

Appendix E

Respondent contends that petitioner has not established a business purpose for owning the residence at 4460 Bay Point Road and therefore, none of the expenses associated with it are deductible by Gayety. Respondent further contends that even if petitioner hosted entertainers at the home, he falls short of proving the home was used primarily for business purposes.

Conversely, petitioner contends that business use of the property is only relevant to the extent it may serve to justify petitioner's being charged less than fair rental value for the house. Otherwise, petitioner claims that because he was charged rent, the rent was reported as income by Gayety, and the amount flowed through to petitioner as Gayety's sole shareholder, that Gayety is entitled to depreciate the cost of the residence. We agree with respondent.

We believe the primary purpose of acquiring and maintaining the residence was to provide a home for petitioner's personal use and pleasure. Furthermore, without any evidence as to the percentage of business petitioner carried on at the home, we have no basis to allocate expenses between business use and personal use in 1974 or 1975.[24]

Finally, petitioner claims that if Gayety's ownership is disregarded and its deductions are disallowed, the adjusting journal entries for rent should be reversed because petitioner included that amount which flowed through the S corporation in his income for 1974, 1975 and 1976. We disagree. We are not disregarding Gayety's ownership of the residence. Gayety

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24. See n. 23, *supra*.

is still entitled to deductions for taxes and interest. We have determined that Gayety did not have a business purpose for the purchase and rental of the residence; therefore, it is denied those deductions which are predicated on business purpose (Sections 162 and 167). Furthermore, contrary to petitioner's argument, there is no reason to reverse the journal entries which increased petitioner's loans due to Gayety. Petitioner has failed to prove he actually made cash payments to Gayety to cover the rental expenses accrued to his loan account. Moreover, petitioner, in effect, merely rented a house from Gayety. If petitioner had rented elsewhere, his rental payments would be income to the landlord, and a nondeductible personal expense to petitioner. Here, Gayety, the landlord, received and accrued rental income in the form of an increase in petitioner's shareholder loan account. As with any landlord, such income is properly attributable to Gayety, even though, under the circumstances, it may not deduct maintenance and depreciation for lack of business purpose. Petitioner received a benefit for which he paid.[25] Neither the benefit, nor the payments, is reversed merely because Gayety is a subchapter S corporation and petitioner is its sole shareholder.[26]

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25. Since there is no evidence that petitioner paid off the accrued rental expenses the "payment" is evidenced by an increase in income which flowed through to him as sole shareholder of Gayety.

26. Respondent has not raised the issue of whether petitioner received additional income for the rental value of the home in 1977 and 1978, years in which he paid no rent in any form. As a result, we make no such finding.

In sum, Gayety is allowed the deductions for interest and taxes, but all other maintenance type deductions were properly disallowed, as was depreciation.

Basis in Paris Follies

Petitioner maintained open loan accounts with all of his corporations. Until 1974 petitioner's corporations each also maintained an "LP Theater" (Loans payable, Theater) account. The LP Theater accounts were designed to reflect the total amount of outstanding intercompany loans. During the 1974 taxable year the LP Theater accounts were replaced with reciprocal accounts to record the intercompany transactions. Petitioner closed out the LP Theater accounts when he changed to reciprocal accounts.

Petitioner did not retroactively allocate the amounts outstanding in the LP Theater accounts among his corporations. Instead, petitioner interjected himself individually into the middle of the transactions and either credited or debited his open loan account to reflect the balance in the LP Theater account. Thus, a corporation which had a positive balance in its LP Theater account became indebted to petitioner rather than any of the other corporations. Simultaneously, petitioner became indebted to those corporations which had negative LP Theater accounts by taking on the debts of other corporations.

In 1974 Paris Follies had a positive balance of $82,823 in its LP Theater account. After making the adjusting journal entries, Paris Follies' books indicated the corporation was indebted to petitioner for $82,823.

Appendix E

Petitioner also claims that in 1977 similar journal entries were made. The loan accounts between Paris Follies and GTI, Cameo and Griffco indicated that Paris Follies was indebted to the extent of $85,063.50. Specifically, Paris Follies owed GTI $19,771.52, it owed Cameo $3,086.96 and it owed Griffco $62,205.02. According to petitioner, adjustments were made so that the amounts Paris Follies owed these three entities were then owed to petitioner. Again petitioner claims these journal entries served to decrease petitioner's basis in GTI, Cameo and Griffco while simultaneously increasing his basis in Paris Follies. The only amount in controversy here is the $62,205.02 owed to Griffco.

In 1975 Paris Follies owned and operated the Capitol Theater in Chattanooga, Tenn. During 1975 improvements were made on the Capitol Theater. Petitioner claims to have personally expended $12,670.30 on the improvements at the Capitol Theater.

Also in 1975 petitioner had advanced $91,655 to Griffco. In that same year, Griffco advanced a total of $119,487.85 to Paris Follies. The advance was in the form of one payment of $62,353.33 and a second payment of $57,134.52. In 1975 petitioner withdrew $45,790.62 in excess of his contribution from Paris Follies. If Griffco had not advanced the $91,655 to Paris Follies earlier that year, petitioner would have been unable to make this withdrawal.

In his notice of deficiency respondent determined that petitioner was not entitled to a loss suffered by Paris Follies in 1974 in the amount of $39,508.58 because the loss exceeded petitioner's basis in the S corporation. Respondent

also determined that petitioner realized taxable income in 1975 and 1976 in the respective amounts of $37,609.62 and $55,158.88 reflecting the extent to which loan repayments exceeded petitioner's basis in Paris Follies. We must decide: (1) whether journal entries on the books of Paris Follies, which substituted petitioner as a creditor of Paris Follies for certain of petitioner's other wholly owned S corporations, increased petitioner's basis in Paris Follies; (2) whether expenditures made in 1975 for improvements on the Capitol Theater serve to increase petitioner's basis in Paris Follies; and (3) whether advances from Griffco to Paris Follies increased petitioner's basis in Paris Follies.

(1) *Paris Follies Journal Entries*

Under former section 1374[27] a shareholder's loss is limited to his adjusted basis in his stock plus his adjusted

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27. Former sec. 1374 as in effect during the years in issue provided:

CORPORATION NET OPERATING LOSS ALLOWED TO SHAREHOLDERS.

Sec. 1374 [1954 Code]. (a) GENERAL RULE. — A net operating loss of an electing small business corporation for any taxable year shall be allowed as a deduction from gross income of the shareholders of such corporation in the manner and to the extent set forth in this section.

(b) ALLOWANCE OF DEDUCTION. — Each person who is a shareholder of an electing small business

(Cont'd)

Appendix E

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corporation at any time during a taxable year of the corporation in which it has a net operating loss shall be allowed as a deduction from gross income, for his taxable year in which or with which the taxable year of the corporation ends (or for the final taxable year of a shareholder who dies before the end of the corporation's taxable year), an amount equal to his portion of the corporation's net operating loss (as determined under subsection (c)). The deduction allowed by this subsection shall, for purposes of this chapter, be considered as a deduction attributable to a trade or business carried on by the shareholder.

(c) DETERMINATION OF SHAREHOLDER'S PORTION. —

(1) IN GENERAL. — For purposes of this section, a shareholder's portion of the net operating loss of an electing small business corporation is his pro rata share of the corporation's net operating loss (computed as provided in section 172(c), except that the deductions provided in part VIII (except section 248) of subchapter B shall not be allowed) for his taxable year in which or with which the taxable year of the corporation ends. For purposes of this paragraph, a shareholder's pro rata share of the corporation's net operating loss is the sum of the portions of the corporation's daily net operating loss attributable on a pro rata basis to the shares held by him on each day of the taxable year. For purposes of the

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preceding sentence, the corporation's daily net operating loss is the corporation's net operating loss divided by the number of days in the taxable year.

(2) LIMITATION. — A shareholder's portion of the net operating loss of an electing small business corporation for any taxable year shall not exceed the sum of —

(A) the adjusted basis (determined without regard to any adjustment under section 1376 for the taxable year) of the shareholder's stock in the electing small business corporation, determined as of the close of the taxable year of the corporation (or, in respect of stock sold or otherwise disposed of during such taxable year, as of the day before the day of such sale or other disposition), and

(B) the adjusted basis (determined without regard to any adjustment under section 1376 for the taxable year) of any indebtedness of the corporation to the shareholder, determined as of the close of the taxable year of the corporation (or, if the shareholder is not a shareholder as of the close

(Cont'd)

basis in any indebtedness owed to him by the corporation. Sec. 1374. Moreover, in S corporations, loan repayments in excess of a shareholder's basis are taxable income to that shareholder. Cornelius v. Commissioner, 494 F.2d 465 (5th Cir. 1974).

Petitioner contends the adjusting journal entries which occurred when he changed from using LP Theater accounts to reciprocal accounts in effect served to increase his basis in some of his corporations while correspondingly decreasing his basis in other corporations. Petitioner relies on section 1374(c)(2)(B) claiming the adjusting journal entries for Paris Follies altered the adjusted basis of indebtedness of the Paris Follies to him as its shareholder, and therefore increased the net operating loss he was entitled to claim for the 1974 taxable year.

Petitioner further asserts that the advances made by his other corporations to cover the expenses of Paris Follies came from "either funds petitioner had contributed to [his]

(Cont'd)

> of such taxable year, as of the close of the last day in such taxable year on which the shareholder was a shareholder in the corporation).

In 1982 Congress revised the rules pertaining to subchapter S corporations in the Subchapter S Revision Act of 1982, Pub. L. 97-354, 96 Stat. 1669. The revisions in the 1982 Act do not apply in this case, however, because they apply only to taxable years beginning after December 31, 1982. Section 6(a), Subchapter S Revision Act of 1982, Pub. L. 97-354, 96 Stat. 1669, 1697.

corporations or previously taxed income. In either event the amounts previously had been taxed to petitioner as Subchapter S pass through income or compensation." According to petitioner, this is further evidence of petitioner's entitlement to an increase of his basis in Paris Follies.

Respondent argues that actual economic outlay is required before section 1374(c)(2)(B) applies; that in this case petitioner merely made paper changes in the indebtedness between his corporations and himself; that petitioner failed to show he actually paid out any monies on behalf of Paris Follies; and that shifting of journal entries did not leave petitioner in a materially poorer situation. We agree with respondent.

In *Underwood v. Commissioner*, 63 T.C. 468 (1975), affd. 535 F.2d 309 (1976), we faced a similar question. In that case taxpayers, husband and wife, were the sole shareholders of two corporations operating cafeterias specializing in barbecue. One of the corporations (Albuquerque) made an election to be treated as a subchapter S corporation. The regular corporation (Lubbock) was very profitable and made a series of loans to Albuquerque in return for demand notes bearing six percent interest.

In order to increase their basis to be able to absorb the subchapter S loss, Lubbock surrendered the demand notes it was holding, the taxpayers substituted a personal demand note to replace it and the S corporation issued a demand note for the same amount to the taxpayers. The net effect was that, after the paper transactions, the taxpayers owed Lubbock

for the loan it had originally made to the S corporation and the S corporation owed money to the taxpayers.

Before the transactions the S corporation had never made any payments of principal or interest on the loans. Sometime later the S corporation paid all of the accrued interest owing to Lubbock. The taxpayers also made an interest payment. A year later the S corporation made another interest payment to Lubbock. Approximately a year or so after that the taxpayers made another payment for interest and ultimately paid off the loan.

In holding that the transaction did not serve to increase the taxpayer's basis in the S corporation, both the Tax Court and the Fifth Circuit analogized the transaction to a loan guarantee. Furthermore, in affirming the Tax Court decision the Fifth Circuit stated:

> In the transaction at issue in this case, the taxpayers in 1967 merely exchanged demand notes between themselves and their wholly owned corporations; they advanced no funds to either Lubbock or Albuquerque. Neither at the time of the transaction, nor at any other time prior to or during 1969 was it clear that the taxpayers would ever make a demand upon themselves, through Lubbock, for payment of their note. Hence, as in the guaranty situation, until they actually paid their debt to Lubbock in 1970 the taxpayers had made no additional investment in Albuquerque that would increase their adjusted basis in an indebtedness of Albuquerque to them within the

meaning of section 1374(c)(2)(B). [535 F.2d at 312. Footnote refs. omitted.]

Petitioner argues that the facts in *Underwood* are substantially different from the facts of this case because *Underwood* involved loans between an S corporation and a C corporation whereas here the loans were between all wholly owned S corporations. It is apparently petitioner's position that in this case the funds advanced to Paris Follies came from previously taxed income so there was an economic outlay by petitioner in addition to his decrease in basis to other of his S corporations. We do not agree.

The evidence does not support petitioner's contention that the advanced funds must have come from previously taxed income. Rather, the facts indicate petitioner did not receive any net income from his subchapter S corporations between 1974 and 1978. He only received $35,000 in salary in 1974. More importantly, there is no evidence to indicate that petitioner increased his investment in Paris Follies. These journal entries are merely paper transactions without economic substance.

Petitioner acknowledges that the transactions at issue in the instant case are appropriately analogized to the shareholder loan guarantee situation. In so acknowledging, however, petitioner claims this Court is bound by the decision of *Selfe v. United States*, 778 F.2d 769 (11th Cir. 1985), and that he is therefore entitled to increase his basis in Paris Follies.

In *Estate of Leavitt v. Commissioner*, 90 T.C. 206 (1988), we reiterated our position that the guarantee of loan without

actual economic outlay does not increase a shareholders' basis in the corporation. However, the Eleventh Circuit, in *Selfe v. United States*, 778 F.2d 769 (11th Cir. 1985), held that although economic outlay is required to increase a shareholder's basis, it is not always necessary for the shareholder to actually absolve the corporation's debt to pass the test. If the facts demonstrate that in substance the shareholder borrowed funds and advanced them to the corporation, an increase in basis is warranted. The instant case is appealable to the Eleventh Circuit, and we are constrained to follow the law in that circuit (*Golsen v. Commissioner*, 54 T.C. 742 (1970), affd. 445 F.2d 985 (10th Cir. 1971)). However, the facts of the case before us do not fall within the scope of the Eleventh Circuit's holding in *Selfe*.

In *Selfe* the shareholders made loan guarantees to disinterested third parties in arm's-length transactions. Clearly, acting as a guarantor for an arm's-length loan with a disinterested third party is not the same as interjecting oneself as the middleman in several loan obligations between one's wholly owned small business corporations. Consequently, the result here is not controlled by the Eleventh Circuit's holding in *Selfe*.

In this case petitioner is attempting to alter his basis in several of his S corporations by way of journal entries. There does not appear to be any economic substance to these transactions. It is understandable that petitioner wanted to change from using the LP Theater account to reciprocal accounts, but making journal entries attributing the indebtedness and accounts receivable to petitioner is not

equivalent to economic outlay in terms of section 1374. Therefore, petitioner is not entitled to increase his basis in Paris Follies for journal entries made either in 1974 or 1977.

(2) *Capitol Theater Improvements*

In 1975 improvements were made at the Capitol Theater in Chattanooga, Tenn. The Capitol Theater was owned and operated by Paris Follies. Petitioner claims he personally expended $12,670.30 for the improvements which were made.

Petitioner submitted several hundred pages of invoices and receipts for work done or supplies purchased for the Capitol Theater in Chattanooga, Tenn. Many of these bills were paid in cash and others were paid by petitioner's corporations. None of the receipts indicate that the payment came from petitioner. In the absence of any evidence connecting the actual payment with petitioner, there is no reason to increase his basis in Paris Follies.

(3) *Advances from Griffco to Paris Follies*

Petitioner contributed $91,655 to Griffco. In turn Griffco contributed $119,487.85 to Paris Follies. Petitioner then withdrew $45,790.62 in excess of his contributions from Paris Follies.

Petitioner argues that in substance Griffco was merely a conduit for taxpayer's funds to flow to Paris Follies. Presumably, petitioner believes it was as if petitioner contributed $29,301.67 to Griffco and $62,353.33 to Paris

Follies and at year end Paris Follies repaid $45,790.62 to petitioner. Thus, petitioner claims his basis in Paris Follies should reflect these advances.

Respondent argues that petitioner has failed to meet his burden of proof that advances from Griffco to Paris Follies are in substance the same as if petitioner made the contribution to Paris Follies. We agree with respondent. Petitioner has not presented any evidence to support his conduit theory. It appears that petitioner is trying to rearrange what really occurred in order to prevent an increase in his taxable income. We decline to allow petitioner to come in after the fact and "readjust" his bases in his wholly owned S corporations in order to prevent the incidence of taxation on earned income. If what petitioner wanted to do was to "loan" $62,000 in 1975 to Paris Follies and $29,000 to Griffco — that is how he should have structured the arrangement. Petitioner is not entitled to an increase in his basis in Paris Follies for loans made to Griffco which then in turn loaned money to Paris Follies.

Head of Household Filing Status, Income Averaging

(1) *Head of Household*

Petitioner had custody of his sons Charles and Cash, both of whom lived with him at 4460 Bay Point Road. Petitioner's daughter Kim also lived with petitioner even though her mother had legal custody. In addition to providing Kim's housing, he also paid $50 per week for her support and paid for her clothing, education and medical expenses. As a result,

petitioner claims he is entitled to have his taxes determined using the head of household filing status. Sec. 1(b).

Section 1 sets forth the rate of tax to be imposed on taxpayers. Those persons who qualify as head of household are taxed at slightly more favorable rates than other single taxpayers. Head of household is defined in section 2(b). An individual qualifies as the head of a household only if the following requirements are met —

> (1) the taxpayer must be single at the close of the taxable year; and
>
> (2) the taxpayer is not a surviving spouse; and * * *
>
> (3) the taxpayer maintains as his home a household which is the principal place of abode for more than one half of the taxable year of
>
> > (a) a single child or the single descendant of a child; * * *.

Petitioner meets the requirements and is therefore eligible to have his taxes determined using the head of household rates. Petitioner was single during all the years in question. Petitioner was not a surviving spouse and petitioner maintained a household which was the principal place of abode for at least one half of all the years in question for three of his children.

Appendix E

(2) *Income Averaging*

Petitioner claims he is also eligible to income average his taxable income under section 1301[28] for the years in question.

Petitioner raised the issue in his petition. Although respondent perfunctorily denied the allegation in his answer, he did not address the issue at trial or on brief. We therefore deem respondent to agree that petitioner is a person entitled to the benefits of income averaging.

However, since section 1301 relies upon specific computations spanning several years, and since petitioner's taxable income must still be determined for the years in issue, we cannot, at this juncture, determine whether petitioner meets the computational requirement. Therefore, after the tax is computed for all the years in question, if petitioner meets the computational requirements of section 1301 he is entitled to its benefit.

Net Operating Loss Carrybacks and Carryforwards

Petitioner claimed to have suffered net operating losses (NOLs) in 1974, 1975, 1976 and 1977. He filed for refunds in the 1972 taxable year as a result of NOL carrybacks from 1974 and 1975. Sec. 172. Petitioner carried forward NOLs from 1976 and 1977 to 1978. After respondent audited

28. Secs. 1301-1305 were repealed by the Tax Reform Act of 1986, Pub. L. 99-514 sec. 141(a), 100 Stat. 2117.

petitioner and redetermined his income and deductions, petitioner's NOLs for 1974, 1975 and 1976 did not exceed his gross income for those years. If respondent's determination is correct petitioner would not be entitled to any of the NOL carrybacks or carryforwards.

In this case, since petitioner's ultimate gross income and allowable deductions must still be computed it is not yet possible to determine whether NOLs exceed gross income. If after computations there is no NOL in excess of gross income petitioner would not be entitled to any carryback or carryforward and the amounts so claimed must then be recaptured.

The deficiencies from 1969, 1970 and 1973 also resulted from the disallowance of certain investment tax credit (ITC) carrybacks.[29] In 1976 petitioner filed a Form 1045 for a tentative refund of $300, from an unused ITC from 1972. Respondent allowed $60 of the credit to be applied to the 1969 taxable year and $60 to 1970. The remaining $180 was carried forward to 1973. After respondent audited petitioner for 1974, he disallowed an NOL carryback from 1974 to 1972. As a result there was sufficient gross income in 1972 to absorb the $120 unused ITC carried back and the $180 carried forward. Therefore, respondent disallowed the $60 credits in 1969, 1970, and the $180 credit in 1973.

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29. We note that respondent is authorized to make adjustments to the carrybacks of the 1972 ITC because the ITC carryback is attributable to an NOL carryback. See sec. 6501(j); *Herman Bennett Co. v. Commissioner*, 65 T.C. 506, 509-510 (1975).

A similar situation arose in the 1975 taxable year. Petitioner had an unused ITC of $2,956 in that year. He filed a Form 1045 for refund applying the 1975 credit to the 1973 tax year. Respondent did not challenge petitioner's right to the ITC, but determined there was adequate gross income in 1975 to use up the credit in 1975. Again, petitioner's entitlement to a carryback of this credit cannot be determined until the computations in these cases are completed.

Respondent determined that an ITC of $2,649 taken in 1975 was subject to recapture in 1976. The equipment for which the credit was taken was purchased in December 1975 and disposed of in 1976. Section 47(a) provides that when qualified section 38 property is disposed of or ceases to be section 38 property before the expiration of the stated useful life of the property used in determining the amount of the investment tax credit, the taxpayer must recapture the difference between what the credit would have been based upon the actual useful life of the section 38 property and the amount of the credit actually claimed.

Since the equipment in question was not used for three years, the useful life petitioner claimed, no investment tax credit is allowed and the amount taken in 1975 must be recaptured in 1976. Sec. 47(a).

Additional Losses on Corporate Liquidations

Ninth Street Amusement Company, Inc., Adam and Eve Theaters, Inc., and Carib Theater Productions, Inc. went out of business in 1973, 1975 and 1977, respectively. The controversy here is whether petitioner is entitled to claim

bad debt deductions for loans he had outstanding to all the corporations when they went out of business and whether petitioner is entitled to a capital loss on the liquidation of Ninth Street Amusements.

Petitioner claims he is entitled to a bad debt deduction for 1973 in the amount of $6,743 on the liquidation of Ninth Street Amusements Inc., a subchapter S corporation, in addition to a capital loss of $2,826. For 1975 petitioner claims a business bad debt of $17,650 in regard to Adam and Eve Theaters, and for 1977 he claims a business bad debt of $21,778 for the liquidation of Carib Theater.

Respondent contends that petitioner is not entitled to any capital loss or bad debt deduction in 1973. Respondent concedes petitioner is entitled to a $17,650 loss on the liquidation of Adam and Eve Theaters in 1975, but that the amount must be taken as a capital loss, not as a bad debt deduction. Similarly, respondent concedes petitioner is entitled to a loss of $21,778 on the liquidation of Carib Theater Productions, Inc. in 1977, but that it must be taken as a capital loss and not as a bad debt deduction.

We first decide whether petitioner is entitled to either a bad debt deduction and/or a capital loss in 1973. Petitioner contends that he did not receive any assets on the dissolution of Ninth Street Amusements, Inc. Further, petitioner asserts his basis in his corporate stock was $2,826 and that the corporation owed him $6,743 on a loan. In support of his claim petitioner submitted the corporate tax return and his personal tax return for 1973. These documents indicate that petitioner earned $5,000 in salary from Ninth Street

Amusements, Inc., that Ninth Street Amusements, Inc. had net income of $2,743 and that the corporation's cumulative losses decreased from $19,330 to $16,494. Under the circumstances outlined above we are unable to allow petitioner to take both the bad debt deduction and the capital loss. Ninth Street Amusements, Inc. was a subchapter S corporation. As such, net operating losses affected petitioner's basis in the corporation and his basis in any indebtedness owed to him by the corporation. Sec. 1376(b). Petitioner has not proved that he had any basis left either in his stock or the debt owed to him by the corporation. As a result, petitioner is not entitled to either the bad debt deduction or the capital loss in 1973.

We turn now to 1975. Section 166 provides generally for a deduction for any debt which becomes worthless during the taxable year. Section 166(d) excludes noncorporate taxpayers from the benefits of this provision if the debt was a nonbusiness bad debt. Instead, a taxpayer may treat the amount as a short-term capital loss. Nonbusiness bad debts are defined in section 1.166-5(b), Income Tax Regs., of the regulations as any debt other than:

> (1) A debt which is created, or acquired, in the course of a trade or business of the taxpayer, determined without regard to the relationship of the debt to a trade or business of the taxpayer at the time when the debt becomes worthless; or
>
> (2) A debt the loss from the worthlessness of which is incurred in the taxpayer's trade or business.

Appendix E

If there is a proximate relationship between the debt and the taxpayer's trade or business there is a business bad debt. Section 1.166-5(b), Income Tax Regs. The Supreme Court has addressed this issue on several occasions. In *Putnam v. Commissioner*, 352 U.S. 82 (1956), the Court held that an attorney who ventured into the publishing business and who advanced money pursuant to his obligation as a guarantor, was not in the trade or business of publishing. The worthless debts were therefore nonbusiness bad debts and were treated as a capital loss.

In *Whipple v. Commissioner*, 373 U.S. 193 (1963), the taxpayer had made cash advances to a corporation in which he had an approximately 80-percent interest. He did not receive any salary from the corporation. The Supreme Court held that devoting one's time and energy to the affairs of a corporation without more is not the trade or business of that individual. The Court went on to say:

> When the only return is that of an investor, the taxpayer has not satisfied his burden of demonstrating that he is engaged in a trade or business since investing is not a trade or business and the return to the taxpayer, though substantially the product of his services, legally arises not from his own trade or business but from that of the corporation. * * * [373 U.S. at 202.]

In *United States v. Generes*, 405 U.S. 393 (1972), the Supreme Court held that in determining whether a bad debt had a "proximate" relation to the taxpayer's trade or business, the taxpayer had to demonstrate a "dominant," rather than "significant," business motive for making the loan.

Appendix E

Petitioner argues he is entitled to a business bad debt of $17,650 on the liquidation of Adam and Eve Theaters. Adam and Eve was a regular C corporation. Petitioner did not earn a salary from Adam and Eve. Petitioner has provided no evidence that his loans to Adam and Eve were for anything other than the protection of his investment. Therefore, petitioner may only treat his loss in 1975 as a capital loss and not as a business bad debt.

Petitioner similarly claims entitlement to a bad debt deduction in 1977, the first and last year of operation for Carib Theater Productions, a Subchapter S corporation. In that time petitioner drew no salary. He loaned the corporation $112,270 and assumed outstanding liabilities of $16,295 (less a $298 receivable from Ell Gee). The corporation lost $128,665. Respondent did not dispute petitioner's treatment of $106,887 of the loss for Carib Theater productions and concedes petitioner is entitled to the additional $21,778 loss. The issue is thus not whether the loss occurred, but its character.

Petitioner claims the loans were made and the liabilities assumed to protect his salary and subchapter S income. Accordingly petitioner claims the debts qualify as business bad debts and are currently deductible. It is respondent's position that the additional loss must be taken as a capital loss. Respondent relies on the fact that petitioner drew no salary and Carib lost over $100,000 in its only year of operation. Thus, respondent concludes that petitioner could not legitimately have been motivated to loan this money either to protect his salary or his subchapter S income.

Appendix E

On the limited evidence before us we conclude that the amount in dispute was not a business bad debt. It seems rather that petitioner contributed capital to his corporation. Therefore, on the liquidation of the corporation, he is only entitled to treat the loss as a capital loss.

Transferee Liability

In a separate notice of deficiency, docket No. 4032-85, and as an alternative argument respondent assessed deficiencies against petitioner as transferee of GTI. Respondent's primary position is that GTI ceased doing business on March 31, 1975. As a result all payments made to GTI are nondeductible and presumably GTI did not realize income. We agree with respondent's primary position.

The existence of transferee liability presupposes the existence of tax liability on the part of the transferor. See *Januschke v. Commissioner*, 48 T.C. 496 (1967). In this case GTI was not in business after March 31, 1975 and it did not incur any tax liability after that date. As a result, petitioner is not liable as transferee of GTI.[30]

Fraud

Finally, we must determine if petitioner is liable for fraud for 1974 through 1978 inclusive in addition to the years before us solely by reason of respondent's disallowance of investment tax credit carrybacks and carryforwards and net

30. Since there is no transferee liability, the deficiency respondent determined for fraud is also obviously nonexistent.

operating loss carrybacks. Respondent's claim of fraud is based primarily upon the activity of one bank account. Petitioner opened the "My Third Wife, George" bank account in 1973. Petitioner claims the account was opened when he produced a film of the same name, and that the account started as a business account. Petitioner claims further that at some point he began using the account to rent or buy films for rental to his S corporations. Eventually, he began using the account for personal expenses.

Respondent alleges that petitioner used the account to pay personal gambling debts and that many of the deposits into the account came from petitioner's wholly owned corporations which deducted these payments as film rental expenses. In other words, respondent claims that petitioner opened this bank account and used it as a way of fraudulently deducting nondeductible personal expenses. Respondent also alleges that petitioner intentionally kept information about this account from his attorneys and accountants to further conceal his fraudulent scheme.

Petitioner's corporations did, in fact, deduct payments made to the "My Third Wife, George" bank account. The last of these deductions was made in March, 1975. Respondent offered evidence of deposits to and expenditures from the "My Third Wife, George" account for the period August 29, 1975 to August 31, 1976. The bank records indicate that $143,150 was deposited into the account and that $142,800 was expended from the account. The evidence indicates that a large portion (at least $42,500) of the expenditures were made to casinos. These facts, combined with testimony from several witnesses that petitioner gambled, form the crux of respondent's allegations.

Appendix E

Petitioner offered a different explanation for the deductions, deposits and expenditures. Petitioner claims that in 1974 and early 1975 films were in fact rented from the "My Third Wife, George" bank account. Petitioner contends that as a result, the corporations renting the films were entitled to the deductions. Petitioner further asserts that the "My Third Wife, George" account acted as a "rental agent", just as GTI Productions, Inc. did, and that its use as such was eventually phased out. Petitioner asserts that the last deduction in March 1975 supports his claim that the account's use as a rental agent was temporary.

Petitioner states that the fact that checks were paid out of the "My Third Wife, George" account in late 1975 and 1976 to several casinos is irrelevant to a determination of fraud. First, no deposits were deducted by any corporation during the period reflected in the bank records. Second, no deductions were ever taken by the "My Third Wife, George" account for these or any other expenditures. Third, petitioner claims that he owed the casinos money from his lines of credit but that he did not gamble the money away; rather he used the lines of credit as interest-free loans which he then paid back using the "My Third Wife, George" account. Finally, even if the payments were for gambling debts, petitioner argues since no deductions were taken by any of the corporate entities, there is still no evidence of fraud.

Respondent has the burden of proving fraud by clear and convincing evidence. Sec. 7454(a); Rule 142(b). To meet this burden respondent must show petitioner intended to evade taxes known to be owing by conduct intended to conceal, mislead, or otherwise prevent the collection of taxes.

Stoltzfus v. United States, 398 F.2d 1002, 1004 (3d Cir. 1968); *Rowlee v. Commissioner*, 80 T.C. 1111, 1123 (1983). Respondent must prove fraud for each year he asserts the addition to tax under section 6653(b). *Shaw v. Commissioner*, 27 T.C. 561 (1956), affd. 252 F.2d 681 (6th Cir. 1958).

We consider the entire record to determine whether fraud exists. *Estate of Pittard v. Commissioner*, 69 T.C. 391, 400 (1977); *Gajewski v. Commissioner*, 67 T.C. 181, 199 (1976), affd. without published opinion 578 F.2d 1383 (8th Cir. 1978); *Stratton v. Commissioner*, 54 T.C. 255, 284 (1970). Fraud is not imputed or presumed. *Beaver v. Commissioner*, 55 T.C. 85, 92 (1970). Respondent may, however, prove fraud through circumstantial evidence since direct evidence of the taxpayer's intent is rarely available. *Rowlee v. Commissioner*, *supra* at 1123.

We are not entirely convinced that the "My Third Wife, George" account operated in the manner described by petitioner. We are also not convinced that the account was used *entirely* for personal expenses. Respondent was unable to show us by clear and convincing evidence that no film rentals occurred during the time when film rental deductions were taken. The fact that no film rentals occurred after the deductions stopped is not evidence of fraud. Moreover, respondent cannot rely solely on petitioner's failure to prove error in respondent's determination to meet his burden of proving fraud. *Habersham-Bey v. Commissioner*, 78 T.C. 304, 312 (1982); *Otsuki v. Commissioner*, 53 T.C. 96, 106 (1969); *Pigman v. Commissioner*, 31 T.C. 356, 370 (1958).

Respondent's supplemental arguments for fraud rest on what he terms "abusively used corporate deductions and

corporate funds for personal expenses." Respondent claims that excessive travel and entertainment deductions which petitioner could not substantiate, corporate ownership and deduction of expenses for the residence where petitioner lived and large shareholder loans with small amounts of declared taxable income support a finding of fraud.

First, the inability to substantiate a deduction, standing alone, is not fraud. The fact that travel and entertainment substantiation requirements were explained to petitioner by his accountant and that petitioner did not follow his instructions may be evidence of negligence. However, a taxpayer is guilty of fraud only if he claims deductions to which he knows he is not entitled.

Second, the fact that petitioner withdrew substantial sums from his wholly owned corporations in the form of shareholder loans is not fraudulent. In 1974 petitioner received a shareholder loan from GTI Corporation in the amount of $56,311. In 1975 petitioner received a "shareholder loan"[31] from Gayety Theaters in the amount of $72,794. Respondent has failed to prove by clear and convincing evidence that the amounts were not in fact loans. The evidence indicates money flowed freely from one corporation to another often via petitioner's loan accounts. Petitioner had outstanding loan amounts due to certain of his corporations while other of the corporations owed him money. There is no question that petitioner's recordkeeping was very sloppy

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31. We made no factual finding as to the true character of any shareholder loans other than those outstanding with GTI in 1974 and 1975 because such findings were not determinative as to any particular deficiency issue.

and that the sloppiness prevents us from determining exactly what petitioner invested and what he withdrew from his various corporations. While we do not condone such erratic bookkeeping, and we recognize the possibility that the amounts were not truly loans, we nevertheless do not find petitioner possessed the requisite intent to have committed tax fraud.

Finally, respondent claims that since the corporation owned the house petitioner lived in and deducted the cost of maintenance and improvements, petitioner is liable for additions to tax for fraud. We have found that Gayety is not entitled to deduct the cost of maintenance and improvements on the home. However, that does not mean that the plan of corporate ownership of the home was fraudulent. In this case petitioner lost his personal homestead election under Florida law by having the corporation own the residence. Also, during an audit of earlier years, one of respondent's revenue agents indicated to petitioner that corporate ownership of the home would most likely not be a problem if fair rental value was paid. While we were unable to determine whether petitioner ever actually "paid" the rent he accrued to his loan account with Gayety, it seems that petitioner attempted to partially comply with the revenue agent's advice (at least in 1974 through 1976). Thus, we remain unconvinced that Gayety's ownership of the residence amounted to fraud by petitioner.

After having viewed the witnesses at trial and taking note of petitioner's level of formal education, we do not believe he intended to evade taxes he knew were owing. Petitioner is an astute businessman and has hired accountants

to do his tax planning. No evidence presented at trial convinced us that petitioner conveyed an intent to carry out fraudulent schemes with his accountants, nor were we convinced he tried to evade taxes without his accountants' knowledge. Additionally, we do not find fraud in 1969, 1970, 1972 or 1973, the years before us solely by reason of respondent's disallowance of net operating loss carrybacks and investment tax credit carrybacks and carryforwards.

To reflect the foregoing,

Decision in docket No. 22089-80 will be entered under Rule 155.

Decision in docket No. 4032-85 will be entered for petitioner.

Appendix E

APPENDIX A

	1969	1970	1972	1973	1974	1975	1976	1977	1978
1120-S Income — Paris Follies					$12,884	$28,017	$67,409	$ 9,910	$47,419
Distributors Income — Paris Follies						36,610	55,159		
N.O.L. Deduction — Paris Follies					39,509				
1120-S Income — Griffco					12,313	35,384	(8,427)		
1120-S Income — L.C. Griffith					4,021	10,111	14,618	2,780	
1120-S Income — Ell Gee, Inc.					31,908	31,073	24,482	117,558	
1120-S Income — Gayety Theaters					58,054	90,073	88,252	21,301	72,112
Deemed dividend income — GTI					56,682				
Dividend exclusion					(100)				
Long-Term Capital Gain — GTI					8,254	38,947			
Long-Term Capital Gain deduction					(1,389)	(18,736)			
Carryback for year ending 12/31/74		$34,220							
Carryback for year ending 12/31/75		22,794							
Income from Bee Gee, Inc.			4,400		21,700				
Income from Cameo Productions					2,097	3,100			
Income from Flamingo Theater						3,262			
Income from Paramount Security Dep.							24,950		
Income from Carib Theater							21,778		
NOL Carryforward year ending 12/31/77									61,923
NOL Carryforward year ending 12/31/76									21,756
Itemized deduction					(7,511)	(6,167)	(7,081)		
Exemptions					(3,000)	(3,000)	(3,000)		
		$57,014			$216,025	$267,726	$237,774	$198,277	$223,210

Total adjustments per statutory notice of deficiency

Appendix E

APPENDIX B

Disallowed Deduction

	1973	1974	1975	1976	1977	1978
(a) Add'l film expenses		$31,850	$197,014	$149,400	$39,364	$24,553
(b) Finder's fee		10,400	10,400	10,400	4,200	5,200
(c) Add'l auto expenses		3,033.50	1,629	4,926	1,503	
(d) Add'l contract/casual labor		150		3,150	900	
(f) Misc. itemized		8,500		2,700		

Previously Unclaimed Deduction

(g) Add'l losses on corp. liquidation of 9th St. Amusement Adam & Eve Theaters Carib Theater Productions	$2,836					
(h) Add'l unclaimed deductions for						
(1) Rent for Parris Follies Pussycat Theater	23,501		49,918			1,800
(2) Payment w/regard to Liberty Bank & Trust Acct.			10,349.36			
(3) Legal Services	5,000					
(4) For checks disbursed from Intercontinental			31,927			
(i) Advertising ($21,621.33)						
(ii) Taxes ($4,489.45)						
(iii) Utilities ($1,124.49)						
(iv) Salary ($500)						
(v) Film purchases ($1,500)						
(vi) Repairs and maintenance ($200)						
(vii) Legal & accounting fees ($2,462.54)						
(5) Checks to Nat. Film Co.						8,849
(6) Legal fees erroneously charged to P's loan acct.						4,200

Appendix E

APPENDIX C

LOAN ACCOUNTS — OUTSTANDING BALANCES AT YEAR END

	1974		1975		1976		1977		1978	
	Loans to Shareholders	Loans from Shareholders	Loans to Shareholders	Loans from Shareholders	Loans to Shareholders	Loans from Shareholders	Loans to Shareholders	Loans from Shareholders	Loans to Shareholders	Loans from Shareholders
Gayety	-0-	($94,762)	($72,794)	-0-	$82,706	-0-	$343,093	-0-	$370,332	-0-
L.C. Griffith	-0-	(86,549)	83,635	-0-	52,190	-0-	55,377	-0-		
Griffco	-0-	886	-0-	92,541	-0-	68,797				
Paris Follies	-0-	-0-	108,189	102,570	9,014	127,620	9,877	126,394	28,623	134,268
Ell Gee	5,187	157,627	-0-	192,459	-0-	294,869	-0-	276,805		
Carib	____	____	____	____	-0-	112,270	____	____	____	____
	$5,187	($22,798)	$264,618	$387,570	$143,910	$603,556	$408,347	$403,199	$398,955	$134,268

(Per Balance Sheet on Corporate Tax Returns)

APPENDIX F — PUBLISHED OPINION OF THE UNITED STATES COURT OF APPEALS FOR THE ELEVENTH CIRCUIT IN *HAAS v. INTERNAL REVENUE SERVICE*, 48 F.3d 1153 DATED MARCH 30, 1995

In re: Bernice Elizabeth HAAS;
Thomas Milton Haas,

Debtors.

Thomas Milton HAAS; Bernice Elizabeth Haas,

Plaintiffs-Appellants,

v.

INTERNAL REVENUE SERVICE; United States Small Business Administration; Secor Bank,

Defendants-Appellees.

No. 93-6820.

United States Court of Appeals,
Eleventh Circuit.

March 30, 1995.

* * *

Appeal from the United States District Court for the Southern District of Alabama.

Appendix F

Before EDMONDSON and BIRCH, Circuit Judges, and HILL, Senior Circuit Judge.

BIRCH, Circuit Judge:

In this case, we decide whether a debtor "willfully attempt[s] in any manner to evade or defeat [a] tax," for the purposes of 11 U.S.C. § 523(a)(1)(C), when the debtor intentionally fails to pay taxes for which he or she properly filed tax returns and acknowledged were owed to the Internal Revenue Service ("IRS"). The district court determined that such conduct was tax evasion; consequently, it ruled that such taxes are nondischargeable in bankruptcy. We conclude that Congress did not intend such a result; accordingly, we REVERSE.

I. BACKGROUND

Between 1977 and 1985, debtor-appellant Thomas Haas did not pay his income or employment taxes. Although Haas accurately filed his tax returns for the years at issue, he used his income to pay his personal and business debts rather than his tax liability. In 1987, Haas pled guilty for willful failure to pay his income taxes for 1980 to 1982 and his employment taxes for the first three quarters of 1984. Haas received a one-year suspended prison term and five years of probation. One condition of Haas's probation was that he had to remain current in his estimated tax payments and to make monthly payments to be applied to his tax liabilities. Haas substantially complied with the terms of his restitution order.

Appendix F

In 1991, Haas and his wife filed a joint Chapter 11 bankruptcy petition.[1] The government responded by filing a proof of claim for $705,044.25 in unpaid joint income taxes and unpaid employment taxes since 1977. Shortly thereafter, Haas filed an adversary proceeding seeking, inter alia, a determination of the dischargeability of his federal tax liabilities for taxable years ranging from 1977 to 1987. Although the general rule is that Chapter 11 debtors in bankruptcy may discharge "any debt" arising before the confirmation of a debtor's bankruptcy plan, 11 U.S.C. § 1141(d)(1), Congress has excepted certain liabilities from discharge. In particular, a debtor may not discharge any tax liability "with respect to which the debtor made a fraudulent return or willfully attempted in any manner to evade or defeat such tax." 11 U.S.C. § 523(a)(1)(C); see also 11 U.S.C. § 1141(d)(2).

The bankruptcy court found that Haas's tax liabilities for the periods at issue were dischargeable. It held that section 523(a)(1)(C) applied only to the assessment of tax liability and not to the payment thereof. Because Haas did not submit any materially false or misleading tax returns, the court concluded that Haas's failure to pay his taxes did not constitute an attempt to evade or defeat his taxes under section 523(a)(1)(C).

The government appealed to the district court, which vacated the bankruptcy court's decision on the issue and remanded the case for a determination of whether Haas's

1. Although Haas filed joint income tax returns with his wife during the years in question, the dischargeability of his wife's tax liability is not at issue here.

failure to pay was willful. On remand, the bankruptcy court found that Haas made no affirmative attempt to evade or defeat his taxes; rather, Haas used his income to pay debts other than his tax liability.[2] The court again concluded that Haas's tax liabilities did not fall within section 523(a)(1)(C)'s exception to discharge.

The government appealed the bankruptcy court's decision, and the district court reversed. Applying the civil standard for "willful" conduct applicable under the Internal Revenue Code ("I.R.C."), I.R.C. § 6672, the court reasoned that

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2. The bankruptcy court found:

> Mr. Haas filed income tax returns for the years 1977 through 1985 but failed to pay the tax due in connection with the tax returns for 1977 through 1985. Mr. Haas did not engage in any conduct, either prior to or after the filing of the tax returns, evincing an illicit motive to defeat or evade the taxes due for 1977 through 1985. Mr. Haas readily acknowledged the tax liability and, other than his failure to pay the obligation, made no attempt to defeat or evade his obligation. The debtors did not conceal assets, engage in dubious transfers of assets, falsify or destroy books or records, or misstate the amount of income in the respective years at issue. Instead of satisfying the tax liability, Mr. Haas used his income to pay personal and business expenses rather than pay the taxes due. Mr. Haas was under financial pressure and his nonpayment of the taxes was not the result of willful conduct designed to defeat or evade the taxes; but, instead was the result of mistaking the priority and importance of certain financial obligations.

R1-21 (Amended Memorandum Opinion) (emphasis added).

> the most persuasive interpretation of the statutory language at issue is to construe the phrase "willfully attempted in any manner to evade or defeat" to mean: (1) the debtor has a duty under the law, (2) the debtor knew he or she had that duty, and (3) the debtor voluntarily and intentionally violated that duty. . . .
>
> . . . [W]here the debtor is financially able to pay the taxes due, but chooses not to do so, the government has met its burden of proof.

In re Haas, 173 B.R. 756, 758-59 (S.D.Ala.1993). The district court noted that Haas chose not to pay his taxes "and instead used his financial resources for other purposes," in spite of having both an awareness of his duty and the ability to pay. Id. at 759. According to the district court, Haas therefore willfully attempted to evade his taxes, thus rendering his tax liabilities nondischargeable in bankruptcy.

II. DISCUSSION

The sole question at issue in this case is whether a debtor's failure to pay his taxes, without more, constitutes a "willful[ ] attempt[ ] in any manner to evade or defeat such tax" under section 523(a)(1)(C). The proper construction of the Bankruptcy Code, whether by the bankruptcy court or by the district court, is a matter of law; accordingly, we subject such interpretations to de novo review. In re Colortex Industries, Inc., 19 F.3d 1371, 1374 (11th Cir.1994); In re Taylor, 3 F.3d 1512, 1514 (11th Cir.1993).

Appendix F

A. Plain Language Interpretation

Generally, the plain meaning of a statute controls, "except in the 'rare cases [in which] the literal application of a statute will produce a result demonstrably at odds with the intentions of its drafters.' " United States v. Ron Pair Enters., Inc., 489 U.S. 235, 242, 109 S.Ct. 1026, 1031, 103 L.Ed.2d 290 (1989) (alteration in original) (quoting Griffin v. Oceanic Contractors, Inc., 458 U.S. 564, 571, 102 S.Ct. 3245, 3250, 73 L.Ed.2d 973 (1982)). In the present case, the government maintains that the plain meaning of the phrase "willfully attempted in any manner to evade or defeat such tax," § 523(a)(1)(C) (emphasis added), is sufficiently broad to include a debtor's "voluntary, conscious, and intentional" failure to pay taxes, Appellee's Brief at 16. See In re Toti, 24 F.3d 806, 809 (6th Cir.) (holding that a debtor's voluntary, conscious, and intentional failure to file income tax returns and to pay his taxes fell within plain meaning of section 523(a)(1)(C)'s exception to discharge), cert. denied, 513 U.S. 987, 115 S.Ct. 482, 130 L.Ed.2d 395 (1994). The government argues that if a debtor had both an awareness of his duty to pay his taxes and the present ability to pay them but nonetheless failed to satisfy that duty, then the tax liability is nondischargeable under section 523(a)(1)(C).

The difficulty with the government's "plain meaning" interpretation of section 523(a)(1)(C) is that it effectively would make all tax debts nondischargeable. If every knowing failure to pay taxes constituted an evasion of taxes under section 523(a)(1)(C), then discharge of tax liability would be available only to those very few debtors who discovered their debts to the IRS in the course of their bankruptcy

proceedings.[3] Moreover, every debtor, at least in theory, has the present ability to pay his income or employment taxes; if a debtor did not have positive net income, then he would not have been assessed income or employment taxes in the first instance. The government's reading of section 523(a)(1)(C) would allow an exception to swallow the general rule of discharge for tax liabilities.

Such an expansive reading of section 523(a)(1)(C)'s exception to discharge would contravene the Bankruptcy Code's purpose of allowing a fresh start for the honest but unfortunate debtor. See Grogan v. Garner, 498 U.S. 279, 285, 111 S.Ct. 654, 659, 112 L.Ed.2d 755 (1991); In re Miller, 39 F.3d 301, 304 (11th Cir.1994). Under the IRS's interpretation of section 523(a)(1)(C), the only honest debtor would be a debtor who is wholly unaware of her debt to the IRS. However, she also is an honest debtor who, fully cognizant of the debt that she owes to the IRS, uses her income to pay other debts instead. Her failure to pay the IRS is the result of not dishonesty but of the defining characteristic of all debtors — honest and dishonest, alike — insufficient resources to honor all of her obligations. Similarly, Haas technically had the financial ability to pay his taxes, but he still lacked the resources to pay all of his debts. That he decided to use his limited funds to satisfy obligations other than his properly acknowledged income taxes does not render him a dishonest debtor, simply a

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3. Indeed, in its oral argument the government did not recognize any extenuating circumstances which might allow a debtor to pay other obligations ahead of her acknowledged taxes without exempting those unpaid taxes from discharge.

debtor.[4] A literal application of the government's "plain language" interpretation of section 523(a)(1)(C) would thus render the general rule of dischargeability of tax liabilities an empty letter and defeat the central purpose of the Bankruptcy Code. Consequently, we must look to other sources to guide our interpretation of the ambiguous provision.

B. Analogous Internal Revenue Code Provisions

Haas argues that, had Congress intended that the failure to pay, without more, would except tax liabilities from discharge, it could have written such a provision into section 523(a)(1)(C). In fact, using language almost identical to that found in section 523(a)(1)(C), Congress has on four other occasions previous to the enactment of section 523(a)(1)(C)

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4. See In re Sonnenberg, 148 B.R. 35, 38 (Bankr.N.D.Ill.1992) (holding that IRS failed to show that debtors willfully attempted to evade payment of their taxes under section 523(a)(1)(C) despite the fact that debtors consistently filed their returns late and without payments while leading a lavish lifestyle). The court in Sonnenberg emphasized that poor financial management, not dishonesty, led to the debtors' failure to pay their taxes:

> In attempting to work through these difficulties, [debtors] acted with no particular intent to defeat any specific creditor, including the IRS. The Sonnenbergs' downward financial spiral, combined with the maintenance of a lifestyle inconsistent with their financial obligations, finally resulted in the bankruptcy petition which brings them before this Court.

Id.

shown itself capable of distinguishing between evasion of a tax and evasion of the payment of a tax. See I.R.C. § 6531(2) (establishing periods of limitation on criminal prosecutions for various offenses arising under the I.R.C., including "the offense of willfully attempting in any manner to evade or defeat any tax or the payment thereof") (emphasis added)); I.R.C. § 6653 (imposing a penalty upon any person who "willfully attempts in any manner to evade or defeat any such [stamp] tax or the payment thereof" (emphasis added)); I.R.C. § 6672 (imposing a civil penalty upon any person who "willfully attempts in any manner to evade or defeat any such tax or the payment thereof" (emphasis added)); I.R.C. § 7201 (providing that "[a]ny person who willfully attempts in any manner to evade or defeat any tax imposed by this title or the payment thereof shall . . . be guilty of a felony" and subject to a maximum fine of $100,000, a maximum prison term of five years, or both (emphasis added)).

Where Congress knows how to say something but chooses not to, its silence is controlling. BFP v. Resolution Trust Corp., 511 U.S. 531, __, 114 S.Ct. 1757, 1761, 128 L.Ed.2d 556 (1994) (" '[I]t is generally presumed that Congress acts intentionally and purposely when it includes particular language in one section of a statute but omits it in another,' and that presumption is even stronger when the omission entails the replacement of standard legal terminology with a neologism.") (citation omitted) (quoting Chicago v. Environmental Defense Fund, 511 U.S. 328, __, 114 S.Ct. 1588, 1593, 128 L.Ed.2d 302 (1994)); United States v. Jordan, 915 F.2d 622, 628 (11th Cir.1990) (" ' "[W]here Congress includes particular language in one section of a statute but omits it in another section of the same Act, it is

generally presumed that Congress acts intentionally and purposefully in the disparate inclusion or exclusion." ' " (quoting Rodriguez v. United States, 480 U.S. 522, 525, 107 S.Ct. 1391, 1393, 94 L.Ed.2d 533 (1987) (per curiam))), cert. denied, 499 U.S. 979, 111 S.Ct. 1629, 113 L.Ed.2d 725 (1991). Cf. Andrus v. Glover Constr. Co., 446 U.S. 608, 616-17, 100 S.Ct. 1905, 1910, 64 L.Ed.2d 548 (1980) ("Where Congress explicitly enumerates certain exceptions to a general prohibition, additional exceptions are not to be implied, in the absence of evidence of a contrary legislative intent."). We note, however, that in this case, the similar sections in the I.R.C. and section 523(a)(1)(C) are neither part of the same title, nor the same statute. Nevertheless, omissions or inclusions in the former are relevant to our construction of the latter because Congress is presumed to be aware of pertinent, existing law when it passes legislation. Miles v. Apex Marine Corp., 498 U.S. 19, 30, 111 S.Ct. 317, 325, 112 L.Ed.2d 275 (1990); Goodyear Atomic Corp. v. Miller, 486 U.S. 174, 184-85, 108 S.Ct. 1704, 1712, 100 L.Ed.2d 158 (1988). This presumption is particularly strong in the case of I.R.C. § 7201. Section 7201 is not an obscure provision; it is the principal enforcement provision of the I.R.C., " 'the capstone of a system of sanctions which singly or in combination were calculated to induce prompt and forthright fulfillment of every duty under the income tax law and to provide a penalty suitable to every degree of delinquency.' " Sansone v. United States, 380 U.S. 343, 350-51, 85 S.Ct. 1004, 1010, 13 L.Ed.2d 882 (1965) (quoting Spies v. United States, 317 U.S. 492, 497, 63 S.Ct. 364, 367, 87 L.Ed. 418 (1943)). As such, section 7201 was certainly pertinent to any bankruptcy provision intended to delineate

which unpaid taxes would be dischargeable in bankruptcy and which would remain with the debtor.[5]

Therefore, we must presume that Congress was aware of both the language and the judicial interpretation of section 7201 when it drafted section 523(a)(1)(C). Jordan, 915 F.2d at 628 ("Under accepted rules of statutory construction, it is generally presumed that Congress, in drafting legislation, is aware of well-established judicial construction of other pertinent existing statutes."). Moreover, that the language of section 523(a)(1)(C) is nearly identical to that used in section 7201 indicates that Congress was not only constructively but also actually aware of its I.R.C. precedents when it drafted the bankruptcy provision.

In determining the scope of section 7201, the Supreme Court has recognized that the statute "includes the offense of willfully attempting to evade or defeat the assessment of a tax as well as the offense of willfully attempting to evade or defeat the payment of a tax." Sansone, 380 U.S. at 354, 85 S.Ct. at 1011. Whereas section 7201 penalizes a taxpayer who either "willfully attempts in any manner to evade or defeat any tax imposed by this title or the payment thereof,"

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5. All of the I.R.C. provisions using language similar to that found in section 523(a)(1)(C) were originally enacted in 1954, prior to the 1966 amendment to the Bankruptcy Act. See Internal Revenue Code of 1954, Pub.L. No. 83-591, §§ 6531, 6653, 6672, 7201, 68A Stat. 3, 815, 822-23, 828, 851 (1954). Congress added the relevant language to section 523(a)(1)(C) in 1966 and 1978, after the original versions of the above I.R.C. provisions were in place. See textual discussion, infra. Sections 6653 and 6672 have since been amended and continue to contain this particular language.

section 523(a)(1)(C) excepts from discharge only those taxes with respect to which the debtor "willfully attempted in any manner to evade or defeat such tax." The omission of the words "or the payment thereof" from section 523(a)(1)(C), in light of Congress's previous inclusion of these words on four previous occasions, indicates that Congress did not intend that a failure to pay taxes, without more, should result in the nondischargeability of a debtor's tax liabilities in bankruptcy. In re Gathwright, 102 B.R. 211, 213 (Bankr.D.Or.1989) (comparing section 523(a)(1)(C) to 26 U.S.C. § 7201 and concluding that failure to pay taxes does not constitute a willful attempt to evade or defeat a tax under section 523(a)(1)(C)).

C. Legislative History

The legislative history of section 523(a)(1)(C) supports this narrower reading of the statute.[6] Prior to 1966, taxes were not dischargeable in bankruptcy. See Bankruptcy Act of 1898, ch. 541, § 17a(1), 30 Stat. 544, 550 (1898) (codified as amended at 11 U.S.C. § 523(a)(1)(C)). In 1966, using language nearly identical to that found in the I.R.C., Congress first allowed debtors to discharge certain taxes. Excepted from discharge were any taxes "with respect to which the bankrupt . . . willfully attempted in any manner to evade or defeat. . . ." See Act of July 5, 1966, Pub.L. No. 89-496, 80 Stat. 270 (1966) (amending the Bankruptcy Act with respect

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6. Additionally, this narrow construction of section 523(a)(1)(C) is consistent with our general practice of construing statutory exceptions to discharge in favor of the debtor so as to give effect to the fresh start policy of the Bankruptcy Code. See In re Miller, 39 F.3d 301, 304 (11th Cir.1994).

to the priority and nondischargeability of taxes) (codified as amended at 11 U.S.C. § 523(a)(1)(C)).

Congress adopted the current language of 523(a)(1)(C) in 1978. See Bankruptcy Act of 1978, Pub.L. No. 95-598, § 523, 92 Stat. 2549, 2590 (1978). As reported by one of the bill's sponsors, the final wording of section 523(a)(1) represented a compromise between the original House bill and its Senate amendments. See 124 Cong.Rec. 32,398 (1978) (statement of Rep. Edwards). The House had proposed a version that was essentially unchanged from the 1966 amendment; the bill, H.R. 8200, would have excepted from discharge taxes "with respect to which the debtor . . . willfully attempted in any manner to evade or defeat." 123 Cong.Rec. 35,655 (1977). The Senate version, however, proposed to narrow the exception of section 523(a)(1)(C) by striking the words "in any manner" and imposing a more stringent mens rea standard. Senate bill S. 2266 would have excepted from discharge those taxes "with respect to which the debtor . . . fraudulently attempted to evade or defeat." Senate Comm. on the Judiciary, 85th Cong., 1st Sess., Comparison of H.R. 8200, as Reported, and S. 2266, as Introduced 106 (Comm. Print 1978), reprinted in Bankruptcy Reform Act of 1978: Hearings Before the Subcomm. on Improvements in Judicial Machinery of the Senate Comm. on the Judiciary, 95th Cong., 1st Sess. 3, 108 (1978) (red-lined text of H.R. 8200 omitted).

Although the current provision retains the willfulness standard and the broad phrase "in any manner" contained in H.R. 8200, it qualifies the exception by limiting it to attempts to evade or defeat "such tax." That Congress added the words

"such tax" and not "such tax or payment thereof," as it had four times previously in the I.R.C., reflects congressional recognition that honest debtors may fail to pay their properly acknowledged taxes. We must give effect to Congress's decision to omit the words "or payment thereof" in section 523(a)(1)(C), where it has shown itself capable of including such language. See, e.g., NLRB v. Bildisco and Bildisco, 465 U.S. 513, 522-23, 104 S.Ct. 1188, 1194, 79 L.Ed.2d 482 (1984) (holding that the failure of Congress to draft an exclusion for certain collective bargaining agreements in 11 U.S.C. § 365(a) indicates that the provision applies to all such agreements, in light of the previous use of such an exclusion by Congress in 11 U.S.C. § 1167). Therefore, we hold that a debtor's failure to pay his taxes, alone, does not fall within the scope of section 523(a)(1)(C)'s exception to discharge in bankruptcy.

D. Government Counterarguments

The government raises three principal challenges to this reading of section 523(a)(1)(C). First, it argues that the plain meaning of the words "in any manner" is broad enough to include a debtor's failure to pay a properly acknowledged tax. This view finds support in a number of bankruptcy court decisions. See, e.g., In re Griffith, 161 B.R. 727, 732-33 (Bankr.S.D.Fla.1993) ("[T]he modifying phrase . . . 'in any manner,' is sufficiently broad to include willful attempts . . . to evade taxes by concealing and transferring assets to protect them from execution or attachment."); In re Fridrich, 156 B.R. 41, 43 (D.Neb.1993) ("[T]he language 'in any manner' is sufficiently broad to include attempts by a debtor to evade the payment of taxes previously assessed. . . ."); cf. In re

Toti, 24 F.3d at 809 (holding that section 523(a)(1)(C) excepts both acts of commission and acts of omission, such as where debtor "voluntarily, consciously, and intentionally" failed to file tax returns or to pay taxes).

Congress, however, has consistently used the words "in any manner" and the words "or the payment thereof" in the same section, see §§ 6531(2), 6653, 6672, and 7201; to adopt the government's interpretation of "in any manner" would render "or the payment thereof" superfluous in each of these four provisions. The better view is that the phrase "in any manner" in those sections may modify either attempts to evade or defeat a tax, or attempts to evade or defeat payment thereof, or both, but that its use does not erase the distinction between the assessment and the collection of taxes. Absent explicit language, therefore, the phrase "attempt[s] in any manner to evade or defeat such tax" does not imply attempts to evade or defeat payment thereof.

The government also challenges our narrower reading of "willfully attempted in any manner to evade or defeat such tax" by suggesting that such an interpretation renders the entire phrase superfluous. The government reasons that if one cannot evade or defeat a tax by refusing to pay a properly acknowledged tax, then the only possible way to evade or defeat a tax is by filing a false return. Because filing a false return is covered already in section 523(a)(1)(C), the government argues that Haas's reading of the provision violates the statutory canon that a provision should be interpreted such that every word is given meaningful effect. See In re Jones, 116 B.R. 810, 815 (Bankr.D.Kan.1990) (noting in dicta that "[i]f evading or defeating collection or

payment of a tax does not count, this court is hard-pressed to conceive how a debtor might willfully attempt to evade or defeat a tax without also filing a fraudulent return").

We do not find this argument persuasive. Congress has demonstrated that language prohibiting fraudulent returns is not redundant with language proscribing attempts in any way to evade or defeat the assessment of a tax. As already noted, section 7201 makes it a felony for any person to "willfully attempt[ ] in any manner to evade or defeat any tax imposed by this title or the payment thereof." § 7201. At the same time as it enacted section 7201, Congress also enacted I.R.C. § 7207, which makes it a misdemeanor for any person to "willfully deliver[ ] or disclose[ ] to the Secretary any . . . return . . . known by him to be fraudulent or to be false as to any material matter." § 7207. Since Congress purposely devoted separate sections of the I.R.C. to penalize evasion of a tax or payment thereof and to penalize filing a fraudulent return, it clearly did not consider the scope or effect of these two provisions to be identical.[7]

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7. The Supreme Court has distinguished section 7201 from section 7207 by noting that the government must prove the existence of a tax deficiency before it can convict a defendant under the former provision, but not under the latter. Sansone, 380 U.S. at 352, 85 S.Ct. at 1010 ("Conduct could therefore violate § 7207 without violating § 7201 where the false statement, though material, does not constitute an attempt to evade or defeat taxation because it does not have the requisite effect of reducing the stated tax liability."). But see In re Brackin, 148 B.R. 953, 956 (Bankr.N.D.Ala.1992) (holding that the IRS must prove underpayment of tax in order to prove fraud under section 523(a)(1)(C)); In re Kirk, 98 B.R. 51, 55 (Bankr.M.D.Fla.1989) (same). Although Kirk actually refers to fraud under section 523(a)(1)(A), the citation appears to be in error, as the case addresses fraud under section 523(a)(1)(C).

Mindful of the different judicial interpretations of sections 7201 and 7207, Congress evidently chose to proscribe only selected elements of the conduct described in each provision when drafting section 523(a)(1)(C).

The government also argues that Haas's reading of section 523(a)(1)(C) defeats the statute's purpose of preventing the use of the Bankruptcy Code as a tax evasion device. Congress was well aware of the potential for tax evasion when it debated the Bankruptcy Reform Act of 1978:

> In business cases . . . it is a frequent occurrence that the business will stop paying its taxes before it stops paying its other creditors, because the officers of the business know that detection of nonpayment is more difficult for the taxing authority than it is for a supplier or lender, and that an unpaid supplier quickly stops shipping goods, though an unpaid taxing authority is usually unable to take collection action for months.

H.R.Rep. No. 595, 95th Cong., 1st Sess. 193 (1977), reprinted in 1978 U.S.C.C.A.N., 5787, 6153-54. However, the provision Congress drafted to prevent this form of tax evasion was not section 523(a)(1)(C) but sections 523(a)(1)(A)[8] and 507(a)(8).[9]

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8. Section 523(a)(1)(A) excepts from discharge tax liabilities "of the kind and for the periods specified in section 507(a)(2) or 507(a)(8) of this title, whether or not a claim for such tax was filed or allowed." § 523(a)(1)(A).

9. House Report 595 refers to a proposed provision 11 U.S.C. § 507(6)(A). See H.R.Rep. No. 595, at 190 n. 98, 1978 U.S.C.C.A.N., (Cont'd)

Appendix F

See H.R.Rep. No. 595 at 190 & nn. 97, 98, 1978 U.S.C.C.A.N., at 6151 nn. 97, 98. Explaining the policy behind these provisions, Congress noted that

> [b]ecause it takes a taxing authority time to locate and pursue delinquent tax debtors, taxes are made nondischargeable if they become legally due and owing within three years before bankruptcy. An open-ended dischargeability policy would provide

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(Cont'd)
at 6151 n. 98. This material is currently codified at 11 U.S.C. § 507(a)(8). Compare H.R. 8200, § 507(6)(A), reprinted in 124 Cong.Rec. 32360 (1978), to § 507(a)(8). Section 507(a)(8)(A) creates a priority in bankruptcy for income taxes

> (i) for a taxable year ending on or before the date of the filing of the petition for which a return, if required, is last due, including extensions, after three years before the date of the filing of the petition;
>
> (ii) assessed within 240 days, plus any time plus 30 days during which an offer in compromise with respect to such tax that was made within 240 days after such assessment was pending, before the date of the filing of the petition; or
>
> (iii) other than a tax of a kind specified in section 523(a)(1)(B) or 523(a)(1)(C) of this title, not assessed before, but assessable, under applicable law or by agreement, after, the commencement of the case. . . .

§ 507(a)(8)(A). Section 507(a)(8)(D) creates a priority for employment taxes on wages earned within three years of the debtor's filing of a bankruptcy petition. See § 507(a)(8)(D).

> an opportunity for tax evasion through bankruptcy, by permitting discharge of tax debts before a taxing authority has an opportunity to collect any taxes due.

Id. at 190, 1978 U.S.C.C.A.N., at 6150 (footnote omitted) (emphasis added). Congress enacted section 523(a)(1)(A) and section 507(a)(8) to give taxing authorities time to pursue delinquent income tax debtors and to obtain secured status before the debtor can discharge his tax liability in bankruptcy. See id.

Congress did not intend to grant the IRS an absolute priority in bankruptcy for delinquent taxes, however. Instead, sections 507(a)(8) and 523(a)(1)(A) except from discharge income and employment tax liabilities only for those taxable years ending within three years of the filing of a debtor's bankruptcy petition. See §§ 507(a)(8), 523(a)(1)(A). Congress imposed this three-year limit on the nondischargeability of income and employment taxes "because the taxing authority should not be given priority for taxes that are unassessed or uncollected through a lack of due diligence." H.R.Rep. No. 595, at 191, 1978 U.S.C.C.A.N., at 6151. The government's interpretation of section 523(a)(1)(C) effectively would eliminate the three-year time limit imposed by sections 523(a)(1)(A) and 507(a)(8)(A) and would give the IRS an open-ended priority for tax liabilities regardless of that agency's "lack of due diligence" in collecting properly reported tax liabilities. Thus, the government correctly notes that Congress intended to prevent businesses from paying their other creditors ahead of the IRS. The government is mistaken, however, when it

seeks to remedy this situation by excepting from discharge the whole of Haas's tax liability, per section 523(a)(1)(C), rather than only that portion of Haas's tax debt attributable to the three taxable years preceding his bankruptcy petition, per section 523(a)(1)(A).[10]

III. CONCLUSION

Haas challenges the district court's determination that his intentional failure to pay his taxes constitutes a "willful[ ] attempt[ ] in any manner to evade or defeat such tax" for the purposes of section 523(a)(1)(C). We conclude that Congress has shown itself capable of distinguishing between the evasion of a tax and the evasion of payment thereof; its decision to omit the words "or payment thereof" in section 523(a)(1)(C), despite the inclusion of these words in four previously enacted and nearly identical provisions of the I.R.C., must be given effect. Haas's tax liability does not fall within the scope of section 523(a)(1)(C) and, as such, is dischargeable in bankruptcy. We REVERSE.

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10. Haas does not contest the nondischargeability of his tax liabilities for the three years immediately preceding his filing a bankruptcy petition.